



**CHAPTER 2 - TRADING SOFTWARE AND TECHNOLOGY**

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**The references to Client-Broker agreement, wherever made, in this chapter, stands suitably modified in terms of provisions of SEBI Circular no. CIR/MIRSD/16/2011 dated August 22, 2011 on Simplification and Rationalisation of Trading Account Opening Process.**



## SECTION - 1: INTERNET TRADING

### 1.1 Conditions to be met by Broker for providing Internet Based Trading Service<sup>1</sup>

To provide Internet Based Trading Service the broker will be required to apply to the respective stock exchange for a formal permission. The stock exchange should grant approval or reject the application as the case may be, and communicate its decision to the member within 30 calendar days of the date of completed application submitted to the exchange.

However before giving permission to broker to start internet based services, stock exchange shall ensure that the broker meets the minimum condition of the criteria's mentioned in circular. The criteria's are mentioned as below:

#### i. **Networth Requirement -**

The broker must have a minimum net worth of Rs.50 lacs if the broker is providing the Internet based facility on his own. However, if some brokers collectively approach a service provider for providing the internet trading facility, net worth criteria as stipulated by the stock exchange will apply. The net worth will be computed as per the SEBI circular no FITTC/DC/CIR-1/98 dated June 16, 1998.

#### ii. **Operational and System Requirements :**

- a. **Operational Integrity** - The Stock Exchange must ensure that the system used by the broker has provision for security, reliability and confidentiality of data through use of encryption technology. (Basic minimum security standards are specified in following paras). The Stock Exchange must also ensure that records maintained in electronic form by the broker are not susceptible to manipulation.
- b. **System Capacity** - The Stock Exchange must ensure that the brokers maintain adequate backup systems and data storage capacity. The Stock Exchange must also ensure that the brokers have adequate system capacity for handling data transfer, and arranged for alternative means of communications in case of Internet link failure.
- c. **Qualified Personnel** - The Stock Exchange must lay down the minimum qualification for personnel to ensure that the broker has suitably qualified and adequate personnel to handle communication including trading instructions as well as other back office work which is likely to increase because of higher volumes.

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<sup>1</sup> Circular No. SMDRP/POLICY/CIR- 06/2000 dated January 31, 2000



- d. **Written Procedures - Stock Exchange must develop uniform written** procedures to handle contingency situations and for review of incoming and outgoing electronic correspondence.
- e. **Signature Verification/ Authentication** - It is desirable that participants use authentication technologies. For this purpose it should be mandatory for participants to use certification agencies as and when notified by Government / SEBI. They should also clearly specify when manual signatures would be required.

iii. **Client Broker Relationship -**

- a. **Know Your Client** - The Stock Exchange must ensure that brokers comply with all requirements of “Know Your Client” and have sufficient, verifiable information about clients, which would facilitate risk evaluation of clients.
- b. **Broker-Client Agreement** - Brokers must enter into an agreement with clients spelling out all obligations and rights. This agreement should also include inter alia, the minimum service standards to be maintained by the broker for such services specified by SEBI/Exchanges for the Internet based trading from time to time. Exchanges will prepare a model agreement for this purpose. The broker agreement with clients should not have any clause that is less stringent/contrary to the conditions stipulated in the model agreement prepared by the Exchanges for this purpose.
- c. **Investor Information** - The broker web site providing the internet based trading facility should contain information meant for investor protection such as rules and regulations affecting client broker relationship, arbitration rules, investor protection rules etc. The broker web site providing the Internet based trading facility should also provide and display prominently, hyper link to the web site/ page on the web site of the relevant stock exchange(s) displaying rules/ regulations/circulars. Ticker/quote/order book displayed on the web-site of the broker should display the time stamp as well as the source of such information against the given information.
- d. **Order/Trade Confirmation** - Order/Trade confirmation should also be sent to the investor through email at client’s discretion at the time period specified by the client in addition to the other mode of display of such confirmations on real time basis on the broker web site. The investor should be allowed to specify the time interval on the web site itself within which he would like to receive this information through email. Facility for reconfirmation of orders which are larger than that specified by the member’s risk management system should be provided on the internet based system.



- e. **Handling Complaints by Investors** - Exchanges should monitor complaints from investors regarding service provided by brokers to ensure a minimum level of service. Exchange should have separate cell specifically to handle Internet trading related complaints. It is desirable that exchanges should also have facility for on-line registration of complaints on their website.

iv. **Risk Management** -

Exchanges must ensure that brokers have a system-based control on the trading limits of clients, and exposures taken by clients. Brokers must set pre-defined limits on the exposure and turnover of each client.

The broker systems should be capable of assessing the risk of the client as soon as the order comes in. The client should be informed of acceptance/rejection of the order within a reasonable period. In case system based control rejects an order because of client having exceeded limits etc., the broker system may have a review and release facility to allow the order to pass through.

Reports on margin requirements, payment and delivery obligations, etc. should be informed to the client through the system.

- v. **Contract Notes** - Contract notes must be issued to clients as per existing regulations, within 24 hours of the trade execution.
- vi. **Cross Trades** - As in the case of existing system, brokers using Internet based systems for routing client orders will not be allowed to cross trades of their clients with each other. All orders must be offered to the market for matching.
- vii. **Others** - The other criteria's mentioned deal with Network Security Protocols and Interface Standards, Network Security, Standards of Web Interface Protocols and System operations.

In addition to the requirements mentioned above, all existing obligations of the broker as per current regulations will continue without changes.

## 1.2 **Securities Trading through Wireless medium on Wireless Application Protocol (WAP) platform.<sup>2</sup>**

A broker providing stock trading through WAP must be a SEBI registered broker who also has an Internet website which complies with all the requirements laid down by SEBI in its circular no. SMDRP/Policy/Cir-06/2000 dated January 31, 2000. With regard to the requirements mentioned in the aforesaid circular, some additional requirements are to be

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<sup>2</sup> Circular No. SMDRP/Policy/Cir-48/2000 dated October 11, 2000



met by the broker for providing securities transaction through WAP. These requirements are provided in the following criteria's:

**i. Network Security**

- a. The break in data encryption at the WAP gateway server raises security issues. Until the shortcoming is addressed by WAP, the WAP server should be hosted by the broker itself and not by a third party.
- b. Suitable firewalls should be installed between trading set-up directly connected to an Exchange trading system and the WAP server.
- c. WTLS (Wireless Transport Layer Security) level security or a higher level of security (as and when available) for wireless communication is mandatory for wireless transactions.
- d. The WTLS encrypts data upto the WAP Gateway server. Transmission from the WAP Gateway server to the Internet server should be secured using Secured Socket Level Security, preferably with 128 bit encryption, for server access through Internet. Alternately, the WAP Gateway server and Internet server may be co-hosted. The server resource should not be shared for any other applications.
- e. The following security measures applicable for fixed Internet based systems should be made mandatory:
  - i) User ID
  - ii) First Level password (Private code)
  - iii) Automatic expiry of passwords at the end of a reasonable duration. Reinitialize access on entering fresh passwords
  - iv) All transaction logs with proper audit facilities to be maintained in the system.
- f. Digitally signed transactions ensure client authentication and support non-repudiation. Digital certification should be mandatory for participants as and when certification agencies are notified by Government / SEBI.
- g. In case of failure of the network, alternative means of communication such as telephone, Internet or e-mail should be available.

**ii. Price Quotes/ Order/ Trade Confirmations**

- a. Stock quotes should be time-stamped.
- b. All orders and trades must be identified by a unique ID. Order confirmation must be provided to the user on submitting the order. Order modification/



cancellation facilities must also be provided. This may be provided using alternate protocols in case the same is not supported by WAP.

- c. Trade confirmation should be provided to the user through e-mail and/or on the mobile phone.

**iii. System operations.**

- a. Brokers should follow the similar logic/priorities used by the Exchange to treat client orders.
- b. Orders/ trades placed through either fixed Internet or WAP system should be accessible from both systems.
- c. Brokers should maintain all activities/ alerts log with audit trail facility.
- d. Broker Web Server should have internally generated unique numbering for all client order/trades.

**iv. Risk Management.**

It is emphasised that risk management should be comprehensive and the risk management systems should take into account the overall positions of clients, irrespective of the medium of trading.

**1.3 Securities Trading using Wireless Technology<sup>3</sup>**

1. It has been decided that SEBI registered brokers who provide Internet Based Trading as specified by SEBI circular no. SMDRP/POLICY/CIR-06/2000 dated January 31, 2000 shall be eligible to provide securities trading using wireless technology. All relevant requirements applicable to internet based trading shall also be applicable to securities trading using wireless technology.
2. Securities Trading using Wireless technology shall include devices such as mobile phone, laptop with data card, etc, that use Internet Protocol (IP).
3. In addition, the stock exchange shall ensure that the broker complies with the following -
  - a. There shall be secure access, encryption and security of communication for internet based trading and securities trading using wireless technology. DOT policy and regulation shall govern the level of encryption.
  - b. Adequate measures should be taken for user identification, authentication and access control using means such as user-id, passwords, smart cards, biometric devices or other reliable means, to prevent misuse of facility by unauthorized persons.

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<sup>3</sup> Circular No. CIR/MRD/DP/ 25/2010 dated August 27, 2010



- c. Unique identification number as given in case of internet based trading shall be made applicable for securities trading using wireless technology.
- d. In case of failure of the wireless network, alternative means of communication for placing orders should be available.
- e. Additional provisions specifying possible risks, responsibilities and liabilities associated with securities trading using wireless technology should be incorporated in the Broker-Client agreement as an addendum or by bringing to the notice of clients, who are desirous of availing such facility, and taking their concurrence on the same.
- f. As it may not be possible to give detailed information to the investor on a hand held device e.g. mobile phones, it may be ensured that minimum information may be given with addresses of the Internet web site/web page where detailed information would be available.
- g. Order confirmation should be provided to the user on submitting the order. Order modification / cancellation facilities should also be provided. Trade confirmation should be provided to the user, along with history of trades for the day.
- h. Session login details should not be stored on the devices used for internet based trading and securities trading using wireless technology.
- i. Network security protocols and interface standards should be as per prevalent industry standards and sound audit trails should be available for all transactions conducted using wireless devices.
- j. The broker's server routing orders to the exchange trading system shall be located in India.
- k. Stock exchanges shall arrange for periodic systems audits of broker systems to ensure that requirements specified in the circulars are being met.
- l. Stock exchange shall also include securities trading using wireless technology in their ongoing investor awareness and educational programme

#### **1.4 Additional Requirements for Internet Based Trading (IBT) and Securities trading using Wireless Technology (STWT)<sup>4</sup>**

1. The stock exchange shall ensure that the broker comply with the following -
  - a. The broker shall capture the IP (Internet Protocol) address (from where the orders are originating), for all IBT/ STWT orders.
  - b. The brokers system should have built-in high system availability to address any single point failure.

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<sup>4</sup> Circular No. CIR/MRD/DP/08/2011 dated June 30, 2011



- c. There should be secure end-to-end encryption for all data transmission between the client and the broker through a Secure Standardized Protocol. A procedure of mutual authentication between the client and the broker server should be implemented.
- d. The broker system should have adequate safety features to ensure it is not susceptible to internal/ external attacks.
- e. In case of failure of IBT/ STWT, the alternate channel of communication shall have adequate capabilities for client identification and authentication.
- f. Two-factor authentication for login session may be implemented for all orders emanating using Internet Protocol. Public Key Infrastructure (PKI) based implementation using digital signatures, supported by one of the agencies certified by the government of India, is advisable. Further the two factors in the Two-factor authentication framework should not be same.
- g. In case of no activity by the client, the system should provide for automatic trading session logout.

Further to the above, the following practice is advisable -

- h. The back-up and restore systems implemented by the broker should be adequate to deliver sustained performance and high availability. The broker system should have on-site as well as remote site back-up capabilities.



## **SECTION - 2: DIRECT MARKET ACCESS**

### **2.1 Direct Market Access Facility<sup>5</sup>**

Direct Market Access (DMA) is a facility which allows brokers to offer clients direct access to the exchange trading system through the broker's infrastructure without manual intervention by the broker. Some of the advantages offered by DMA are direct control of clients over orders, faster execution of client orders, reduced risk of errors associated with manual order entry, greater transparency, increased liquidity, lower impact costs for large orders, better audit trails and better use of hedging and arbitrage opportunities through the use of decision support tools / algorithms for trading.

While ensuring conformity with the provisions of the Securities Contract (Regulations) Act, 1956 (42 of 1956), Stock Exchanges may facilitate Direct Market Access for investors subject to the following conditions:

### **2.2 Application for Direct Market Access (DMA) facility**

Brokers interested to offer DMA facility shall apply to the respective stock exchanges giving details of the software and systems proposed to be used, which shall be duly certified by a Security Auditor as reliable.

The stock exchange should grant approval or reject the application as the case may be, and communicate its decision to the member within 30 calendar days of the date of completed application submitted to the exchange.

The stock exchange, before giving permission to brokers to offer DMA facility shall ensure the fulfillment of the conditions specified hereinafter.

### **2.3 Operational specifications**

All DMA orders shall be routed to the exchange trading system through the broker's trading system. The broker's server routing DMA orders to the exchange trading system shall be located in India.

The broker should ensure sound audit trail for all DMA orders and trades, and be able to provide identification of actual user-id for all such orders and trades. The audit trail data should be available for at least 5 years.

Exchanges should be able to identify and distinguish DMA orders and trades from other orders and trades. Exchanges shall maintain statistical data on DMA trades and provide information on the same to SEBI on a need basis.

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<sup>5</sup> Circular No. MRD/ DoP/SE/Cir- 7 /2008 dated April 03, 2008.



The DMA system shall have sufficient security features including password protection for the user ID, automatic expiry of passwords at the end of a reasonable duration, and re-initialisation of access on entering fresh passwords.

In case where the clients access the DMA server of the broker through a third party service provider, the password maintenance and authentication can be done either by the broker or by third party network service provider, so long as the exchange/broker ensures secured access and communication and a sound audit trail for all DMA orders/trades. The authorized user and client details should be part of the order details received and authenticated at the DMA server of the broker.<sup>6</sup>

Brokers should follow the similar logic/priorities used by the Exchange to treat DMA client orders. Brokers should maintain all activities/ alerts log with audit trail facility. The DMA Server should have internally generated unique numbering for all such client order/trades.

A systems audit of the DMA systems and software shall be periodically carried out by the broker as may be specified by the exchange and certificate in this regard shall be submitted to the exchange.

The exchanges and brokers should provide for adequate systems and procedures to handle the DMA trades.

## **2.4 Terms and Conditions<sup>7</sup>**

- i. Exchange shall specify from time to time the categories of investors to whom the DMA facility can be extended. Currently, this facility is available for institutional clients. Brokers shall specifically authorize clients or investment managers acting on behalf of clients for providing DMA facility, after fulfilling Know Your Client requirements and carrying out necessary due diligence. The broker shall maintain proper records of such due diligence.
- ii. In order to bring uniformity on the requirement of documentation for trading account opening process, in view of the SEBI circular no CIR/MIRSD/16/2011 dated August 22, 2011, the specific Broker - Client Agreement for the purpose of DMA shall be replaced with the "Terms and Condition" document as specified at Annexure I. The "Terms and Conditions" shall be provided to the client or investment manager acting on behalf of a client (s) for availing the DMA facility. In case the DMA facility provided by the stock broker is used by the client the paragraphs one to eighteen of Part A of Annexure-I shall be applicable. In case the DMA facility provided by the stock broker is used by the client through an investment manager the paragraphs one to eighteen of Part B of Annexure-I shall be applicable and additionally, the investment manager shall provide to the stock broker the details as specified at Annexure-II.

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<sup>6</sup> Letter no MRD/DoP/NSE/129791/2008 dated June 24, 2008

<sup>7</sup> Circular No. CIR/MRD/DP/20/2012 dated August 02, 2012



## **2.5 DMA Facility through Investment Manager<sup>8</sup>**

- i. The facility of DMA provided by the stock broker shall be used by the client or an investment manager of the client. A SEBI registered entity shall be permitted to act as an investment manager on behalf of institutional clients. In case the facility of DMA is used by the client through an investment manager, the investment manager may execute the necessary documents on behalf of the client(s).
- ii. The exchange/ broker shall ensure that proper audit trails are available to establish identity of the ultimate client.

## **2.6 Risk Management**

The broker shall ensure that trading limits/ exposure limits/ position limits are set for all DMA clients based on risk assessment, credit quality and available margins of the client. The broker system shall have appropriate authority levels to ensure that the limits can be set up only by persons authorized by the risk / compliance manager.

The broker shall ensure that all DMA orders are routed through electronic/automated risk management systems of the broker to carry out appropriate validations of all risk parameters including Quantity Limits, Price Range Checks, Order Value, and Credit Checks before the orders are released to the Exchange.

All DMA orders shall be subjected to the following limits:

- (a) Order quantity / order value limit in terms of price and quantity specified for the client.
- (b) All the position limits which are specified in the derivatives segment as applicable.
- (c) Net position that can be outstanding so as to fully cover the risk emanating from the trades with the available margins of the specific client.
- (d) Appropriate limits for securities which are subject to FII limits as specified by RBI.

The broker may provide for additional risk management parameters as they may consider appropriate.

## **2.7 Broker to be liable for DMA trades**

The broker shall be fully responsible and liable for all orders emanating through their DMA systems. It shall be the responsibility of the broker to ensure that only clients who fulfill the eligibility criteria are permitted to use the DMA facility.

## **2.8 Cross Trades**

Brokers using DMA facility for routing client orders shall not be allowed to cross trades of their clients with each other. All orders must be offered to the market for matching.

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<sup>8</sup> Circular No. MRD/ DP/20/2012 dated August 02, 2012



**2.9 Other legal provisions**

In addition to the requirements mentioned above, all existing obligations of the broker as per current regulations and circulars will continue without change. Exchanges may also like to specify additional safeguards / conditions as they may deem fit for allowing DMA facilities to their brokers.



**ANNEXURE I**  
**TERMS AND CONDITIONS**  
**PART - A: DMA FACILITY USED BY THE CLIENT**

1. The client is expected to be fully aware of the risks associated with the market and the financial instruments being traded on stock exchanges through DMA. The client shall be responsible for complying with laws, rules, regulations, notifications etc issued by regulatory authorities as may be applicable from time to time.
2. The client shall ensure that DMA facility provided by the Broker is used only to execute the trades of the client and shall not be used for transactions on behalf of any other person / entity.
3. The client shall be responsible for ensuring that, only persons authorized by it shall access and use the DMA facility provided by the Broker. All orders originating from such facility / system shall be deemed to be authorized by the client.
4. Where the client accesses or proposes to access the Broker's DMA platform through external applications, including but not restricted to services of third party service provider(s), own application(s), etc., the client shall ensure that such applications have adequate security features including but not limited to access controls, password protection etc; and that appropriate agreement(s) with such third party service provider(s) etc. for ensuring secured access and communication has been executed and are in place.
5. The client shall ensure that no person authorized by them to place orders through DMA facility provided by the broker has been / is involved in any adverse action by any regulatory authorities in any jurisdiction.
6. The client shall provide the names of authorized individual users to the broker prior to placing DMA orders.
7. The client shall not use or allow the use of DMA facility to engage in any form of market misconduct including insider trading and market manipulation or conduct that is otherwise in breach of applicable laws, rules and regulation.
8. The client is aware that Algorithmic trading i.e. generation of orders using automated execution logic is governed by Algorithmic trading guidelines issued by SEBI and Exchanges and requires prior approval of the exchanges. The client shall ensure that new algorithms and changes to existing approved algorithms are not used through the DMA facility without prior approval of concerned stock exchanges. The client



shall ensure that it has necessary checks and balances, in place to identify and control dysfunctional algorithms and the Broker shall have the right to shut down the DMA facility and remove any outstanding client orders in case of any suspected dysfunctional algo.

9. The client is aware that authentication technologies and strict security measures are required for routing orders through DMA facility and undertakes to ensure that the password of the client and/or his representative are not revealed to any third party.
10. The client acknowledges that all DMA orders placed by them through the DMA facility would be validated by the risk management system of the broker. The Broker has the right to accept or reject any DMA order placed by the client at its sole discretion.
11. The client shall be solely responsible for all acts or omissions of any person using a DMA facility and shall be bound to accept and settle all transactions executed through the DMA facility provided by the Broker notwithstanding that such order(s) may have been submitted erroneously or by an unauthorized user, or that its data is inaccurate or incomplete when submitted, or the client subsequently determines for whatever reason that the order should not have been submitted.
12. The client shall notify the Broker in the event of DMA facility being compromised. Upon receipt of this notice, client's DMA facility shall be promptly disabled but the client shall continue to be responsible for any misuse of the DMA facility or any orders placed through the DMA facility as a result of the compromise of the DMA facility at their end. The Broker shall not be liable for any loss, liability or cost whatsoever arising as a result of any unauthorized use of DMA facility at the client's end.
13. In the event of winding-up or insolvency of the client or his otherwise becoming incapable of settling their DMA obligation, broker may close out the transaction of the client as permissible under bye-laws, rules, regulations of the exchanges. The client shall continue to be liable for any losses, costs, damages arising thereof.
14. The client is fully aware of the risks of transmitting DMA orders to the Broker's DMA facility through vendor systems or service providers and the Broker is not responsible for such risks.
15. The client should be aware of the fact that neither the DMA facility will be uninterrupted nor error free nor the results that may be obtained from the use of the service or as to the timeliness, sequence, accuracy, completeness, reliability or content of any information, service or transaction provided through DMA. The DMA service is provided on an "as is", "as available" basis without warranties of any kind, either



express or implied, including, but not limited to, those of information access, order execution, merchantability and fitness for a particular purpose. The Broker shall not be liable for any loss, damage or injury including but not limited to direct lost profits or trading losses or any consequential, special, incidental, indirect, or similar damages from the use or inability to use the service or any part thereof.

16. The Broker shall have the right to withdraw the DMA facility in case of:-
  - a. Breach of the limits imposed by the broker or any regulatory authority.
  - b. On account of any misuse of the DMA facility by the client or on instructions from SEBI/Exchanges.
  - c. Any other reason, at the discretion of the broker

Broker shall endeavor to give reasonable notice to the client in such instances

17. The Broker shall not be liable or responsible for non-execution of the DMA orders of the client due to any link/system failure at the client/ Broker/ exchange(s) end.
18. This document shall not be altered, amended and /or modified by the parties in a manner that shall be in contravention of any other provisions of this document. Any additional terms and conditions should not be in contravention with rules / regulations /bye-laws/circulars, of the relevant authorities including applicable stock exchanges as amended from time to time.



**PART - B: DMA FACILITY USED BY THE CLIENT THROUGH AN INVESTMENT MANAGER**

1. The client shall be solely responsible for all acts or omissions of any person using a DMA facility and shall be bound to accept and settle all transactions executed through the DMA facility provided by the Broker to the investment manager acting on behalf of the client, notwithstanding that such order(s) may have been submitted erroneously or by an unauthorized user, or that its data is inaccurate or incomplete when submitted, or the client subsequently determines for whatever reason that the order should not have been submitted.
2. The investment manager is expected to be fully aware of the risks associated with the market and the financial instruments being traded on stock exchanges through DMA. The investment manager shall be responsible for complying with laws, rules, regulations, notifications etc issued by regulatory authorities as may be applicable from time to time.
3. Where the DMA facility provided by the Broker is used to execute trade on behalf of one or more clients, by the investment manager, then it is represented and warranted that, at each time an order is placed by such investment manager through the DMA facility of the Broker -
  - a. The investment manager has due authority to deal on behalf of the client(s) through the Broker, specifying the roles and responsibilities of the investment manager in execution of transactions on behalf of the client(s).
  - b. The investment manager shall comply with any applicable laws, rules and regulations affecting or relating to trading operations.
  - c. The investment manager and the client(s) are bound by the terms and conditions hereof;
  - d. The investment manager using the DMA facility for routing client(s) orders shall not cross trades of their client(s) with each other. Accordingly, all orders should be offered in the market.
  - e. The stock exchange or SEBI may at any time call for any information from a client(s) or an investment manager acting on behalf of the client(s) with respect to any matter relating to the activity of the investment manager. The investment manager shall also furnish any information specifying the roles and responsibilities of the investment manager in execution of transactions on behalf of the client(s), as and when required by the exchanges or SEBI.
4. The investment manager shall be responsible for ensuring that, only persons authorized by it shall access and use the DMA facility provided by the Broker. All



orders originating from such facility / system shall be deemed to be authorized by the client.

5. Where the investment manager accesses or proposes to access the Broker's DMA platform through external applications, including but not restricted to services of third party service provider(s), own application(s), etc., the investment manager shall ensure that such applications have adequate security features including but not limited to access controls, password protection etc; and that appropriate agreement(s) with such third party service provider(s) etc. for ensuring secured access and communication has been executed and are in place.
6. The investment manager shall ensure that no person authorized by them to place orders through DMA facility provided by the broker has been / is involved in any adverse action by any regulatory authorities in any jurisdiction.
7. The investment manager shall provide the names of authorized individual users to the broker prior to placing DMA orders.
8. The investment manager shall not use or allow the use of DMA facility to engage in any form of market misconduct including insider trading and market manipulation or conduct that is otherwise in breach of applicable laws, rules and regulation.
9. The investment manager is aware that Algorithmic trading i.e. generation of orders using automated execution logic is governed by Algorithmic trading guidelines issued by SEBI and Exchanges and requires prior approval of the exchanges. The investment manager shall ensure that new algorithms and changes to existing approved algorithms are not used through the DMA facility without prior approval of concerned stock exchanges. The investment manager shall ensure that it has necessary checks and balances, in place to identify and control dysfunctional algorithms and the Broker shall have the right to shut down the DMA facility and remove any outstanding client orders in case of any suspected dysfunctional algo.
10. The investment manager is aware that authentication technologies and strict security measures are required for routing orders through DMA facility and undertakes to ensure that the password of the investment manager and/or his representative are not revealed to any third party.
11. The investment manager acknowledges that all DMA orders placed by them through the DMA facility would be validated by the risk management system of the broker. The Broker has the right to accept or reject any DMA order placed by the investment manager at its sole discretion.



12. The investment manager shall notify the Broker in the event of DMA facility being compromised. Upon receipt of this notice, client's DMA facility shall be promptly disabled but the client shall continue to be responsible for any misuse of the DMA facility or any orders placed through the DMA facility as a result of the compromise of the DMA facility at their end. The Broker shall not be liable for any loss, liability or cost whatsoever arising as a result of any unauthorized use of DMA facility at the client's end.
13. In the event of winding-up or insolvency of the client or his otherwise becoming incapable of honoring their DMA obligation, broker may close out the transaction of the client as permissible under bye-laws, rules, regulations of the exchanges. The client shall continue to be liable for any losses, costs, damages arising thereof.
14. The investment manager is fully aware of the risks of transmitting DMA orders to the Broker's DMA facility through vendor systems or service providers and the Broker is not responsible for such risks.
15. The investment manager should be aware of the fact that neither the DMA facility will be uninterrupted nor error free nor the results that may be obtained from the use of the service or as to the timeliness, sequence, accuracy, completeness, reliability or content of any information, service or transaction provided through DMA. The DMA service is provided on an "as is", "as available" basis without warranties of any kind, either express or implied, including, but not limited to, those of information access, order execution, merchantability and fitness for a particular purpose. The Broker shall not be liable for any loss, damage or injury including but not limited to direct lost profits or trading losses or any consequential, special, incidental, indirect, or similar damages from the use or inability to use the service or any part thereof.
16. The Broker shall have the right to withdraw the DMA facility in case of:-
  - a. Breach of the limits imposed by the broker or any regulatory authority.
  - b. On account of any misuse of the DMA facility by the client/ investment manager or on instructions from SEBI/Exchanges.
  - c. Any other reason, at the discretion of the brokerBroker shall endeavor to give reasonable notice to the client in such instances.
17. The Broker shall not be liable or responsible for non-execution of the DMA orders of the client due to any link/system failure at the client/Broker/exchange(s) end.
18. This document shall not be altered, amended and /or modified by the parties in a manner that shall be in contravention of any other provisions of this document. Any additional terms and conditions should not be in contravention with



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rules/regulations /bye-laws/circulars, of the relevant authorities including applicable stock exchanges as amended from time to time.



**ANNEXURE II**  
**On the letter head of the Investment manager**

**PART A**

DETAILS OF THE INVESTMENT MANAGER:

NAME OF THE INVESTMENT MANAGER:

NAME OF THE HOME REGULATOR:

COUNTRY OF JURISDICTION OF HOME  
REGULATOR:

REGISTERED /REGULATED IN HOME  
JURISDICTION AS:

SEBI REGISTRATION NUMBER:

**PART B**

CLIENT(s) DETAILS:

S. No.	Name of the entity	Name of the regulator	Regulated in India as	Registration Number	PAN



## SECTION - 3: ELECTRONIC CONTRACT NOTE

### 3.1 Use of Digital Signature on Contract Notes<sup>9</sup>

Pursuant to the discussions in the SMAC and provisions of the IT Act, it is clarified that the brokers are allowed to issue contract notes authenticated by means of digital signatures provided that the broker has obtained digital signature certificate from Certifying Authority under the IT Act, 2000. Mode of confirmation by the client may be as specified in the agreement between the broker and the client.

### 3.2 Issuance of Contract Notes in electronic form<sup>10</sup>

The contract notes can be issued by the brokers in electronic form authenticated by means of digital signatures.

### 3.3 Electronic issuance of contract notes – Additional conditions<sup>11</sup>

All the members of stock exchanges who are desirous of issuing Electronic Contract Notes (ECNs) to their clients shall comply with the following conditions:-

#### I. Issuing ECNs when specifically consented

The digitally signed ECNs may be sent only to those clients who have opted to receive the contract notes in an electronic form, either in the Member – Client agreement / Tripartite agreement or by a separate letter. The mode of confirmation shall be as per the agreement entered into with the clients.

#### II. Where to send ECNs

The usual mode of delivery of ECNs to the clients shall be through e-mail. For this purpose, the client shall provide an appropriate e-mail account to the member which shall be made available at all times for such receipts of ECNs.

#### III. Requirement of digital signature

All ECNs sent through the e-mail shall be digitally signed, encrypted, non-tamperable and shall comply with the provisions of the IT Act, 2000. In case the ECN is sent through e-mail as an attachment, the attached file shall also be secured with the digital signature, encrypted and non-tamperable.

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<sup>9</sup> Circular No. SMDRP/POLICY/CIR-56/00 dated December 15, 2000

<sup>10</sup> Circular No. SEBI/SMD/SE/15/2003/29/04 dated April 29, 2003

<sup>11</sup> Circular No. MRD/DoP/SE/Cir-20/2005 dated September 8, 2005



**IV. Requirements for acknowledgement, proof of delivery, log report etc.**

i. Acknowledgement

The acknowledgement of the e-mail shall be retained by the member in a soft and non-tamperable form.

ii. Proof of delivery

- a. The proof of delivery i.e., log report generated by the system at the time of sending the contract notes shall be maintained by the member for the specified period under the extant regulations of SEBI/stock exchanges and shall be made available during inspection, audit, etc.
- b. The member shall clearly communicate to the client in the agreement executed with the client for this purpose that non-receipt of bounced mail notification by the member shall amount to delivery of the contract note at the e-mail ID of the client.

iii. Log Report for rejected or bounced mails

- a. The log report shall also provide the details of the contract notes that are not delivered to the client/e-mails rejected or bounced back.
- b. Also, the member shall take all possible steps (including settings of mail servers, etc.) to ensure receipt of notification of bounced mails by the member at all times within the stipulated time period under the extant regulations of SEBI/stock exchanges.

**V. When to issue or send in Physical mode**

i. Issue in Physical mode

In the case of those clients who do not opt to receive the contract notes in the electronic form, the member shall continue to send contract notes in the physical mode to such clients.

ii. Send in Physical mode

Wherever the ECNs have not been delivered to the client or has been rejected (bouncing of mails) by the e-mail ID of the client, the member shall send a physical contract note to the client within the stipulated time under the extant regulations of SEBI/stock exchanges and maintain the proof of delivery of such physical contract notes.



## VI. General requirements

### i. ECNs through website

In addition to the e-mail communication of the ECNs in the manner stated above, in order to further strengthen the electronic communication channel, the member shall simultaneously publish the ECN on his designated web-site in a secured way and enable relevant access to the clients.

### ii. Access to the website

In order to enable clients to access the ECNs posted in the designated website in a secured way, the member shall allot a unique user name and password for the purpose, with an option to the client to access the same and save the contract note electronically or take a print out of the same.

### iii. Preservation/ Archive of electronic documents

The member shall retain/archive such electronic documents as per the extant rules/regulations/circulars/guidelines issued by SEBI/Stock Exchanges from time to time.

## 3.4 **Format for Issuance of Electronic Contract Notes<sup>12</sup>**

The format of the electronic contract notes, prescribed by the exchanges were not in conformity with the format of the physical contract note particularly with respect to the pre-printed terms and conditions. Hence members issuing electronic contract notes were also issuing physical contract notes which amounted to duplication and unnecessary reconciliation between the physical and electronic contract notes.

In order to streamline the issuance of electronic contract notes as a legal document like the physical contract note, the exchanges are advised to implement the following:

- i. The exchanges would prescribe a standard format for the electronic contract note (based on the model format prescribed in Annexure (for [Equity](#)) and (for [Debt](#))<sup>13</sup>) in its bye-laws, rules and regulations.
- ii. The exchange bye-laws, rules and regulations for issuance of electronic contract note shall be amended to include all the standard pre-printed terms and conditions in the physical contract note. The electronic contract note would mention the

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<sup>12</sup> Circular No. DNP/ Cir-9/04 dated February 3, 2004

<sup>13</sup> Circular No. SEBI/MRD/SE/Cir-11/2004 dated February 25, 2004



relevant bye-laws / rules / regulations of the exchange subject to which the said contract note is being issued.

- iii. The exchange shall also modify / amend other relevant bye-laws, rules and regulations with respect to signing of the electronic contract note with a digital signature so as to make the modified format of the electronic contract note a valid legal document like the physical contract note.
- iv. The mechanism of record keeping of electronic contract notes in a soft non-tamperable form shall be prescribed by the exchange in compliance with the provisions of the IT Act, 2000.



## **SECTION - 4: STRAIGHT THROUGH PROCESSING**

### **4.1 Mechanism<sup>14</sup>**

Straight through Processing (STP) is generally understood to be a mechanism that automates the end to end processing of transactions of financial instruments. It involves use of a system to process or control all elements of the work flow of a financial transaction, what are commonly known as the Front, Middle, Back office and General Ledger. In other words, STP allows electronic capturing and processing of transactions in one pass from the point of order origination to final settlement. STP thus streamlines the process of trade execution and settlement and avoids manual entry and re-entry of the details of the same trade by different market intermediaries and participants. Usage of STP enables orders to be processed, confirmed, settled in a shorter time period and in a more cost effective manner with fewer errors. Apart from compressing the clearing and settlement time, STP also provides a flexible, cost effective infrastructure, which enables e-business expansion through online processing and access to enterprise data.

It has been mandated that all the institutional trades executed on the stock exchanges would be processed through the STP System.

### **4.2 The system flow of the STP framework<sup>15</sup>**

- 1) While several STP Service Providers provide STP service to the market participants to resolve the issue of inter-operability between the STP Service Providers it was decided in consultation with the stock exchanges and the STP Service Providers that a STP Centralised Hub would be setup.
- 2) The system flow for the STP framework shall be as follows: -
  - a) STP user intending to send an instruction would send the message to his STP service provider after digitally signing the same.
  - b) The STP service provider would verify the signature of the STP user and forward it to the
    - i) recipient STP user, if the recipient STP user is availing services of the same STP service provider; or the
    - ii) STP centralized hub if the recipient STP user is not with the same STP service provider. In such a case the STP service provider would be required to prepare a message as per the STP centralized hub prescribed message format, enclose the user's message, digitally sign the message and then send it to the STP centralized hub

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<sup>14</sup> Ref. No. DNP/Dir- 22 /04 dated April 01, 2004

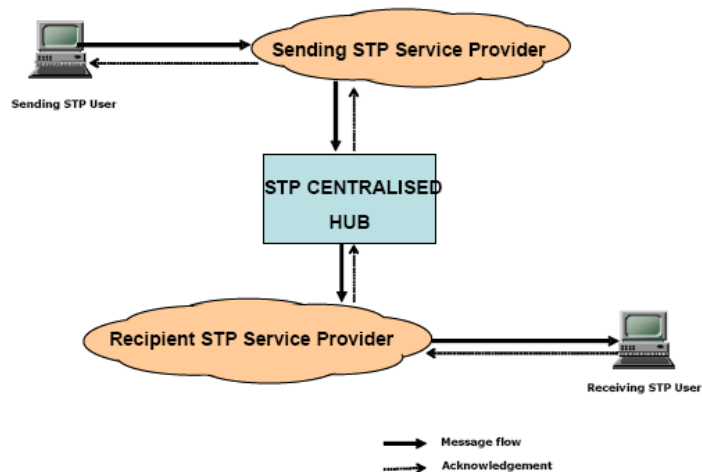
<sup>15</sup> Ref. No. DNP/Dir-23/04 dated April 27, 2004



- c) On receipt of the message by the STP centralized hub, the STP centralized hub would:
    - i) verify the signature of the sending STP service provider only.
    - ii) send an acknowledgment to the sending STP service provider.
  - d) The STP centralized hub would forward the message to the recipient STP service provider after digitally signing on the message.
  - e) The recipient STP service provider on receipt of the message from the STP centralized hub shall verify the signature of the STP centralized hub, verify if the recipient STP user is associated with it and send an appropriate acknowledgment with digital signature to the STP centralized hub. The STP centralized hub would in turn forward the acknowledgment (received from the recipient STP service provider) duly signed to the sending STP service provider.
  - f) The recipient STP service provider shall forward the message to the recipient STP user. The recipient STP user would receive the message and verify the signature of the recipient STP service provider and sending STP user.
- 3) To enable inter-operation, the STP centralized hub would provide a utility / client software to the STP service provider. The STP service provider's point of interface with the STP centralized hub would be through this utility / client software. The PKI (Public key infrastructure) system for the interface shall be implemented at a later stage.
- 4) The block diagram of the entire STP System is enclosed in Annexure I.

Annexure I

Block Diagram of the STP System for inter STP Service Provider  
Transfer of messages



#### 4.3 SEBI (STP centralised hub and STP service providers) Guidelines, 2004<sup>16</sup>

- 1) SEBI in order to regulate the STP service has issued the SEBI (STP centralised hub and STP service providers) Guidelines, 2004 (herein referred to as “STP Guidelines”) which also prescribe the model agreement between the STP centralised hub and the STP service providers.
- 2) The STP guidelines prescribe the eligibility criteria and conditions of approval for the STP centralised hub and the STP service providers, obligations and responsibilities of the STP centralised hub and the STP service providers and code of conduct for the STP service providers. The STP centralised hub and the STP service providers shall abide by these Guidelines.
- 3) To prescribe contractual obligations between the STP centralised hub and the STP service providers and to facilitate standardisation of service, a model agreement between the STP centralised hub and the STP service providers has also been prescribed by SEBI and is prescribed as Schedule II of the STP Guidelines. The agreement between the STP centralised hub and the STP service provider shall include the provisions included in the model agreement.

<sup>16</sup> Ref.No. DNPD/Cir-24/04 dated May 26, 2004 (STP Guidelines)



#### **4.4 Work flow for institutional investors<sup>17</sup>**

1. SEBI in consultation with the STP centralized hub, STP service providers and the STP users has prescribed the transaction work flow for the STP system. All institutional investors shall follow the following transaction work flow on a mandatory basis from July 1, 2004:
  - a. A contract note in electronic form in the prescribed format (IFN 515 messaging format) shall be issued by the broker & sent to the custodian and / or the institutional investor.
  - b. In case the contract note is processed directly by the institutional investor, the institutional investor shall send the trade confirmation of acceptance or rejection of the contract note to the broker by using the IFN 598 messaging format. The custodian shall also send the confirmation of acceptance or rejection of such contract note to the broker using the messaging standard IFN 548.
  - c. In case the contract note is processed by the custodian on behalf of the institutional investor, the custodian shall send the confirmation of acceptance or rejection of the contract note to the broker by using the IFN 548 messaging format.
  - d. The institutional investor shall send settlement instructions to its custodian in IFN 540 to IFN 543 messaging formats to the custodian for the following trade types:
    - i. IFN 540: settlement instruction for a clearing house buy trade
    - ii. IFN 541: settlement instruction for a delivery-v/s-payment (DVP) buy trade
    - iii. IFN 542: settlement instruction for a clearing house sell trade
    - iv. IFN 543: settlement instruction for a delivery-v/s-payment (DVP) sell trade
  - e. The custodian shall confirm / reject the execution of the settlement instructions to the institutional investor in IFN 544 to IFN 547 messaging formats in the following manner:
    - i. IFN 544: confirmation / rejection of an instruction received in messaging format IFN 540
    - ii. IFN 545: confirmation / rejection of an instruction received in messaging format IFN 541

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<sup>17</sup> Ref.No. DNPD/Cir-25/04dated June 10, 2004



- iii. IFN 546: confirmation / rejection of an instruction received in messaging format IFN 542
  - iv. IFN 547: confirmation / rejection of an instruction received in messaging format IFN 543
  - f. It is clarified that if a message (for the activities mentioned above) is sent using the STP centralised hub framework from one user to another user, then the confirmation / rejection for such a message shall also be sent using the STP centralised hub framework.
2. SEBI vide circular no. DNPD/Cir-9/04 dated February 3, 2004 had prescribed the format of the contract note in electronic form. After deliberation with the STP service providers and the market participants the following changes have been incorporated to the existing messaging format (IFN 515):
- a. The mandatory requirement of mentioning the relevant bye-laws / rules / regulations of the exchange subject to which the said contract note is being issued on each contract note stands modified in the following manner:
    - i. The requirement is not mandatory but optional
    - ii. The broker shall ensure that the relevant bye-laws / rules / regulations of the exchange subject to which the contract note is being issued, is mentioned in the broker-client agreement and the tripartite agreement between the broker-sub-broker-client agreement (if applicable).
    - iii. The existing field for the above provision shall not be deleted and may be used as a free text field for one constituent to communicate remarks (if any) to another constituent.
  - b. The clause of 'payment of consolidated stamp duty' for each contract note shall be mentioned in the broker-client agreement and the tripartite agreement between the broker-sub-broker-client agreement (if applicable). The said clause may be stated in the free text field (as mentioned in point 2 (a) (iii) above) of each contract note.
  - c. In the field "market type" (field 70E) a category of 'TT' i.e. trade for trade and 'OT' i.e. Others shall be added to represent the supplementary categories of market types.
  - d. The order time was prescribed as a mandatory field in the contract note. The order time shall now be included in the optional fields.
  - e. There are certain securities which are not de-materialised and hence do not have an ISIN code. For such securities (where ISIN number is not available) the STP users would be required to input the security code given by the exchange in the ISIN number field. In case the number length of the exchange scrip code



is shorter than the prescribed field length of 12 characters, the code shall be prefixed with zeros.

- f. In order to maintain a complete audit trail, it is clarified that in case an electronic contract note is rejected, the custodian (in messaging format IFN 548) or the fund manager (in messaging format IFN 598) shall be required to send a rejection message to the broker. Only on receipt of the rejection message, the broker shall cancel the rejected contract note and issue a fresh contract note bearing a new number.
  - g. In order to bring in standardisation in the input of the identification codes in the prescribed messaging standards, it is clarified that the following codes shall be used by the various entities:
    - i. **Brokers:** SEBI registration number
    - ii. **Mutual Funds and schemes of Mutual Funds:** SEBI registration number for Mutual Funds and Unique client code issued by the exchanges for schemes
    - iii. **FII's and sub-accounts:** SEBI registration number for FII and Unique client code issued by the exchanges for sub-account
    - iv. **Custodians:** SEBI registration number
    - v. **STP service providers and STP centralised hub:** MAPIN ID
    - vi. **Depositories and exchanges / clearing house / clearing corporation:** MAPIN ID.
    - vii. **Other Institutional Investors like financial institutions, banks etc.:** Unique client code issued by the exchanges
  - h. All market participants shall issue the electronic contract note for institutional trades in the modified format enclosed in [Annexure I](#).
3. The prescribed messaging formats for IFN 540, IFN 541, IFN 542, IFN 543, IFN 544, IFN 545, IFN 546, IFN 547, IFN 548 and IFN 598 are enclosed in [Annexure II](#). After consultation with the market participants and confirming their preparedness, it has been decided to make these messaging formats (in addition to IFN 515) mandatory for all institutional trades.
  4. It is reiterated that the STP system shall be initially mandatory for all institutional trades in the equity segment.
  5. The standard terms of contract as are required to be mentioned in the Contract Notes as per the Bye-laws and Regulations of exchanges, which are not contained in electronic contract notes, shall be incorporated in the Client Broker Agreement or where applicable, the Tripartite Agreement between the stock broker, sub-broker and



the client. The stamp duty in respect of the electronic contract notes shall be paid by the broker.

#### **4.5 Clarification<sup>18</sup>**

Descriptors as stated above shall mean the following:

- a. IFN 540: settlement instruction for a buy trade free of payment
- b. IFN 541: settlement instruction for a buy trade against payment
- c. IFN 542: settlement instruction for a sell trade free of payment
- d. IFN 543: settlement instruction for a sell trade against payment
- e. IFN 544: confirmation of a settlement instruction for a buy trade free of payment (response to IFN 540)
- f. IFN 545: confirmation of a settlement instruction for a buy trade against payment (response to IFN 541)
- g. IFN 546: confirmation of a settlement instruction for a sell trade free of payment (response to IFN 542).
- h. IFN 547: confirmation of a settlement instruction for a sell trade against payment (response to IFN 543).

It is also clarified that in the IFN 515 message, if trade is intended to be settled by the custodian with the Clearing Corporation (by accepting the settlement obligation), then it shall be termed as "FREE" and if the trade is intended to be settled by the broker with the Clearing Corporation then it shall be termed as "APMT" (meaning against payment) in the tag 22h of the IFN 515 message.

#### **4.6 Modifications in the prescribed messaging formats<sup>19</sup>**

In order to integrate the STT in the STP system, it would be necessary to provide for necessary fields in the appropriate messaging standards. After deliberation with the STP centralised hub and the STP service providers, it has been decided to make the following modifications in the prescribed messaging formats:

- a) Message Types that shall be modified are IFN515, IFN540, IFN541, IFN542 and IFN543
- b) A Qualifier shall be used to identify Securities Transaction Tax Amount: "COUN", Country, National Federal Tax.

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<sup>18</sup> Ref. No. DNP/14785/04 dated July 08, 2004

<sup>19</sup> Ref. No. DNP/Cir-28/04 dated September 28, 2004



- c) The change in the ISO Structure for the impacted message types shall be as follows:

M	16R		AMT	Start of block	
M	19A	Amount	:4!c//3!a11d	To identify the Securities Transaction Tax Amount	Format: (Qualifier) // (Currency Code) (Amount) For: Securities Transaction tax Amount Qualifier: "COUN" (4 Upper case Characters) Narrative: "INR" (3 Upper Letters) Amount: Up to 10 digits (only Integer value allowed) followed by a comma (used as decimal sign) . Comma is mandatory. Amount can be zero or greater than zero.
M	16S		AMT	End of block	

- d) Securities Transaction Tax Block shall be placed before the Settlement Amount Block in the stated Message Types. (IFN515, IFN540, IFN541, IFN542 and IFN543)
- e) Securities Transaction Tax block will be **mandatory amount block** in IFN515 and **optional amount block** in IFN540, IFN541, IFN542 and IFN543.
- f) If the Contract Note (issued by means of IFN 515) is rejected on the basis of Securities Transaction Tax amount then the reason for the rejection shall be specified in the "Tag70D Narrative" field and "Tag 24B Reason" specified should be "NARR".



## SECTION - 5: TRADING TERMINALS

### 5.1 Testing of software used in or related to Trading and Risk Management<sup>20</sup>

#### Meaning

For the purpose of this section, '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

#### i. 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:

- a. Testing in a simulated test environment: Stock exchanges shall provide suitable facilities to market participants / software vendors to test new software or existing 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.
- b. Mock testing
  - b.1 Stock 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.2 Stock exchanges shall mandate a minimum time period for such testing in the mock trading sessions.
  - b.3 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.

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<sup>20</sup>Circular No. CIR/MRD/DP/24/2013 dated August 19, 2013 and CIR/MRD/DP/06/2014 dated February 07, 2014



- b.4 User Acceptance Test (UAT): The stock broker / trading member shall undertake UAT of the software to satisfy itself that the newly developed / modified software meets its requirements.
- c. 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.
- ii. Stock 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.
- iii. Stock 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.
- iv. Stock 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 stock broker/trading member and if found unsatisfactory, shall suspend the proprietary trading rights of the stock broker / trading member for a minimum period of one trading day.
- v. For pre-approval / periodic system audit of Computer-to-Computer Link (CTCL) or Intermediate Messaging Layer (IML), IBT, DMA, STWT, SOR and AT, stock brokers / trading members shall engage a system auditor with any of the certifications specified vide SEBI circular dated CIR/MRD/DP/16/2013 dated May 21, 2013. 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.



- vi. Approval of Software of stock broker / trading member
- a. Stock brokers / trading members shall seek approval of the respective stock exchanges for deployment of the software in the securities market by submitting necessary details required by stock exchange including details of software, tests undertaken and certificate / report provided by the system auditor. Stock exchange may seek additional details as deemed necessary for evaluating the application of the stock broker / trading member.
  - b. Stock 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.
  - c. Before granting approval to use software in securities market, stock exchange shall ensure that the requirements specified by SEBI / stock exchange with regard to software are met by the stock broker / trading member.
  - d. Stock 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.
- vii. In order to ensure that stock brokers are not using software without requisite approval of the stock exchanges, stock exchanges are advised to put in place suitable mechanism to prevent any unauthorized change to the approved software.
- viii. Undertaking to be provided by stock brokers / trading members
- a. Stock brokers / trading members shall submit an undertaking to the respective stock exchanges stating the following at the minimum:
    1. M/s (name of the stock broker / trading member) 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 software will be tested as per the framework prescribed by SEBI / stock exchange before deployment of such new / modified software in securities market.
    2. M/s (name of the stock broker / trading member) 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.

3. The absolute liability arising from failure to comply with the above provisions shall lie entirely with M/s ..... (name of the stock broker / trading member) .
- b. Stock exchanges may include additional clauses as deemed necessary in the undertaking.
- ix. Sharing of Application Programming Interface (API) specifications by the stock exchange with stock brokers / trading members
  - a. 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. Stock brokers / trading members and software vendors require relevant API specifications to facilitate interaction of the developed software with the systems of the stock exchanges.
  - b. 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.
  - c. Based on the recommendations of the committee, it is decided that stock exchanges shall provide relevant API specifications to all stock brokers / trading members and software vendors who are desirous of developing software for the securities market, after establishing their respective credentials.
  - d. In case of refusal to share APIs, stock 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.
  - e. Further, stock exchanges shall not selectively release updates / modifications, if any, of the existing API specifications to few stock 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.
- x. Penalty on malfunction of software used by stock broker / trading member: Stock exchanges shall examine the cases of malfunctioning of software used by stock brokers / trading members and apply deterrent penalties in form of fines or suspension to the stock broker/trading member whose software malfunctioned. In addition, stock brokers/trading members shall implement various mechanisms including the following to minimize their losses in the event of software malfunction:



- a. include suitable clauses in their agreement with the software vendors to define liabilities of software vendor and stock broker / trading member in case of software malfunction, and / or,
  - b. consider taking suitable insurance cover to meet probable losses in case of software malfunction.
- xi. With regard to changes / updates to stock broker's trading software that intend to modify the 'look and feel' and do not affect the risk management system of the stock broker or the connectivity of the trading software with stock exchange's trading system, it is clarified that mock testing and consequent system audit may not be insisted upon by the stock exchanges.

Stock exchanges shall direct their stock 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.

## 5.2 Standing Committee<sup>21</sup>

A standing Committee shall be set up by each Stock Exchange to investigate the problem of computerised trading system, such as hanging/ slowdown/ breakdown. The Standing Committee shall introduce an outside computer expert. The Committee will submit a report to the Governing Board/ Council of Stock Exchange. The Board/Council will deliberate on the report and suitable action/remedial measure will be taken.

The standing committee is required to be set up with the objective to investigate problems of computerised trading system, such as, **hanging/ slowdown/ breakdown**. With the view to ensure implementation/ compliance, the exchanges are advised as under:-

- i. All instances of hanging / slowdown / breakdown and any other problem in the computerized trading system, even if the disruption is less than five minutes, should be reported to the Committee for its consideration.
- ii. The Committee, upon examination of the issue/s shall submit a report to the Governing Board / Council of the Stock Exchange.
- iii. The Governing Board / Council of the Stock Exchange shall deliberate on the aforesaid report and take suitable action / remedial measure.
- iv. Further, in case of stoppage beyond five minutes the exchange should also explain and report to SEBI about the incident as well as the remedial measures taken. The

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<sup>21</sup> Circular No. MRD/DoP/SE/Cir- 14/2006 dated September 28, 2006



Stock Exchange shall also issue a press release in this regard for greater transparency and in the interest of investors.

### **5.3 Expansion of trading terminals of the Exchange<sup>22</sup>**

The stock exchanges are allowed to set-up terminals at any place in the country, subject to the following conditions:

- i The Exchange would ensure that there is adequate monitoring and surveillance mechanism for such outstation terminals in order to oversee the trades;
- ii All such trades would be subject to usual margin, capital adequacy and inter-day trading limits fixed for the brokers by the Exchange;
- iii The Exchange would ensure that investors eventually do not pay the brokerage on such trades exceeding the maximum brokerage permitted as per the rules of the Exchanges; and
- iv The Exchange would introduce the system of guaranteeing trades or set up a Clearing Corporation.

### **5.4 Broad Guidelines for opening Trading Terminals abroad<sup>23</sup>**

The guidelines relating to eligibility norms, RBI permission, Permission from Foreign Regulatory Authority, Operation Of terminals, Contract note, Settlement Procedure, Surveillance and Monitoring, Jurisdiction etc. for opening trading terminals abroad are provided in the Annexure.

### **5.5 Annexure - Guidelines for Opening of Trading Terminals Abroad**

With the rapid expansion of the Indian capital market it was felt that a facility should be provided whereby an eligible overseas investor can place an order on a real-time basis, rather than telephonically.

The Stock Exchanges/ Members shall follow the following guidelines for opening and maintaining the trading terminals abroad:

#### **a. Eligibility Criteria**

Such trading terminals shall be opened only by the Stock Brokers of the stock exchanges registered with SEBI and opening of terminals through sub-brokers shall not be permitted. These terminals shall be opened by the members only after obtaining permission from the respective stock exchanges.

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<sup>22</sup> Circular No. SMD/POLICY CIR-33/99 dated October 15, 1999

<sup>23</sup> Circular No. SMDRP/POLICY/TTA-14072/CIR-23/99 dated July 12, 1999



**b. RBI Permission**

Such terminals abroad would be opened subject to the guidelines laid down by the RBI from time to time.

**c. Permission by the Foreign Regulatory Authorities**

The installation of such trading terminals shall be subject to the prior permission of the concerned regulatory authorities of the respective foreign countries, wherever required.

**d. Operation of the terminals**

Any investor abroad who is permitted to invest in India i.e. NRIs/OCBs/FIIs/PIOs shall be able to place orders on the trading terminal of the Exchange available at the office of the Indian broker maintained abroad. The order fed on the live terminal shall be executed on the computer of the Exchange in India. The service to the clients shall be provided by the broker's overseas office and its local office. These terminals shall include any of other options that the respective exchange may provide for connecting its trading terminal abroad to its trading system in India.

**e. Contract Note**

The contract note in favour of the client abroad shall be issued in India, however the same could be printed in the broker's office abroad and shall be subject to the jurisdiction of the respective stock exchanges.

**f. Capital Adequacy, Margins System & Brokerage**

All such trades would be subject to usual margins, capital adequacy and intra-day trading limits and such other requirements fixed for the brokers by the Exchange.

The respective stock exchange shall ensure that investors do not pay the brokerage on such trades exceeding the maximum brokerage permitted as per the rules, regulations and bye-laws of the exchange.

No Negotiated Deals shall be permitted through these terminals and only screen based order matching system shall be available on these terminals.

**g. Settlement Procedure**

All trades shall be settled in India in dematerialized form only. Clients with status of FIIs shall settle the trade through their registered custodian/ designated bank. Clients with the status of NRIs/PIOs/OCBs shall settle the trade through a designated bank. Such a designated bank shall be responsible for repatriation of funds.



**h. Monitoring & Surveillance**

The respective stock exchange shall ensure that there is adequate monitoring and surveillance mechanism for such overseas terminals in order to oversee trades.

**i. Grievance Redressal Mechanism**

The investors' grievance for such cases shall be resolved by the respective Indian Stock Exchange through the existing arbitration mechanism.

The concerned Stock Exchange shall ensure that their members have the adequate arrangements for resolving the investors grievances and timely settlement of arbitration cases arising out of trades which are executed on these terminals.

**j. Jurisdiction**

The agreement between the trading member and constituent should, inter alia, state that, all trades, transactions and contracts are subject to the Rules, Bye Laws and Regulations of the Exchange and shall be deemed to be and shall take effect as wholly made, entered into and to be performed in the city of \_\_\_\_\_, India and the parties to such trade shall be deemed to have submitted to the jurisdiction of the Courts in \_\_\_\_\_, India for the purpose of giving effect to the provisions of the Rules, Bye Laws and Regulations of the Exchange.

**5.6 Safeguards to avoid trading disruption in case of failure of software vendor<sup>24</sup>**

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

In view of the above, stock exchanges may advise the stock brokers to take the following measures:

- i. Explore the possibility of establishing a 'software escrow arrangement' with their existing software vendors.
- ii. In case of large stock brokers, consider reducing dependence on a single software vendor for trading and risk management systems, by engaging more than one software vendor.
- iii. Consider including the following in their contracts with the software vendors:

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<sup>24</sup> Circular No. CIR/MRD/DP/07/2014 dated February 11, 2014



- a. access to documents related to design and development specifications in the event software vendor fails to provide continuous and timely services to the stock broker;
- b. development of expertise at the end of the stock broker through appropriate training with regard to software usage and maintenance;
- c. appropriate penalty clauses for cases of disruptions to the trading system of the stock broker on account of (a) software vendor failing to provide continuous and timely services to the stock broker or (b) glitches to the software provided by the software vendor;
- d. obligation on the part of the software vendor to cooperate in case of audit of software including forensic audit, if required.



## SECTION - 6: SMART ORDER ROUTING

### 6.1 Introduction of Smart Order Routing<sup>25</sup>

1. SEBI has received proposal from the stock exchanges and market participants for introducing Smart Order Routing which allows the brokers trading engines to systematically choose the execution destination based on factors viz. price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order.
2. Upon examination of the proposal, feedback of the stock exchanges and based on the recommendations of the Technical Advisory Committee, it has been decided to permit Smart Order Routing in Indian Securities Market.
3. Stock Exchanges are advised to ensure the following conditions with regard to the Smart Order Routing facility:
  - a. Stock broker interested to offer Smart Order Routing facility shall apply to the respective stock exchanges.
  - b. Stock broker shall submit a third party system audit of its Smart Order Routing system and software. Stock exchanges shall disseminate to its stock brokers a list of approved system auditors (CISA or equivalent) qualified to undertake such system audits.
  - c. Stock broker shall provide the following to the respective stock exchanges:
    - i An undertaking to the respective stock exchanges that Smart Order Routing shall route orders in a neutral manner.
    - ii Provide the features of the Smart Order Routing to stock exchange.
  - d. Stock exchange shall communicate its decision to the broker within 30 calendar days from the date of receipt of complete application by the stock exchange. Stock exchange shall not consider testing and demonstration of the SOR system/software as a criterion for declaring the application of the broker as 'complete'. Further, testing and demonstration of SOR system/software, if required, shall be suitably scheduled within the aforesaid period of 30 calendar days.

In case of rejection of the application on smart order routing of a stock broker, the stock exchange shall communicate such reasons of rejections to the stock broker. Further, the decision of the stock exchange on the SOR application of the

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<sup>25</sup> Circular No. CIR/MRD/DP/26/2010 dated August 27, 2010



stock broker and reasons for rejection of the SOR application shall also be communicated to all the other stock exchanges where the broker's SOR facility intends to route orders.<sup>26</sup>

- e. Stock exchange shall ensure that brokers adhere to the best execution policy while using Smart Order Routing.
- f. Smart Order Routing facility shall be provided to all class of investors.
- g. Stock Broker shall communicate to all clients the features, possible risks, rights, responsibilities and liabilities associated with the smart order routing facility. The client desirous of availing such facility shall do so by entering into a broker-client agreement, as applicable. For the existing clients, the same shall be implemented through an addendum to the existing broker-client agreement, as applicable.<sup>27</sup>
- h. Stock broker shall maintain logs of all activities to facilitate audit trail. Broker shall maintain record of orders, trades and data points for the basis of decision.
- i. In case the client has availed Smart Order Routing facility and does not want to use the same for a particular order, the same shall be well documented by the stock broker.
- j. System audit of the Smart Order Routing systems and software shall be periodically carried out by the brokers as may be specified by the exchange and certificate in this regard shall be submitted to the exchange.
- k. Stock exchange shall ensure that Smart Order Routing is not used to place orders at venues other than the recognised stock exchanges.
- l. The stock broker shall carry out appropriate validation of all risk parameters before the orders are placed in the Smart Order Routing system.
- m. Stock exchange shall provide unique identification number for the orders placed through Smart Order Routing system. Further, stock exchanges shall maintain data on Smart Order Routing orders and trades.
- n. Stock exchange shall have necessary surveillance mechanism in place to monitor trading done through Smart Order Routing.

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<sup>26</sup> Circular No. CIR/MRD/DP/ 36 /2010 dated December 09, 2010

<sup>27</sup> Circular No. CIR/MRD/DP/ 36 /2010 dated December 09, 2010



- o. Stock broker shall ensure that alternative mode of trading system is available in case of failure of Smart Order Routing facility.
  - p. Stock exchange shall ensure that within a period of three months from implementation of Smart Order Routing, a system is put in place to time stamp market data feed that is disseminated to the market, if the same is not already available.
  - q. Stock exchange shall strengthen investor grievance cell in order to address complaints, if any, received with regard to Smart Order Routing. Further, in case of any disputes or complaints, stock exchanges shall share necessary data as and when required in order to facilitate necessary examination.
  - r. Stock exchange shall synchronise their system clocks with atomic clock before the start of market.
  - s. The broker server routing orders placed through Smart Order Routing system to the exchange trading system shall be located in India. Stock exchange shall permit SOR approved brokers to offer SOR facility through all their servers irrespective of their location in India.<sup>28</sup>
  - t. All other existing obligations for the broker as per current regulations and circulars will continue.
  - u. Stock exchange may specify additional safeguards as they deem fit for allowing Smart Order Routing facility to their brokers.
  - v. Stock exchange shall permit smart order routing for all orders, without restricting to any specific type of order. The choice on order types shall be left to the client.<sup>29</sup>
  - w. If stock exchange desires to advise its brokers to seek re-approval, it may do so only in case of <sup>30</sup>
    - (a) Inclusion of a new stock exchange for offering SOR facility; and/or,
    - (b) Material changes in the software/system of the smart order routing facility.
4. The initial list of system auditors for SOR for all the three stock exchanges i.e. BSE, NSE and MCX-SX is given below<sup>31</sup> –

<sup>28</sup> Circular No. CIR/MRD/DP/ 36 /2010 dated December 09, 2010

<sup>29</sup> Circular No. CIR/MRD/DP/ 36 /2010 dated December 09, 2010

<sup>30</sup> Circular No. CIR/MRD/DP/ 36 /2010 dated December 09, 2010

<sup>31</sup> Letter no MRD/DoP/ST/OW/11982/11 dated April 08, 2011



- i. HCL Technologies
- ii. iSec Services Pvt. Ltd
- iii. Tata Consultancy Services
- iv. Jain & Jain Chartered Accountants
- v. Kanhere Consultants Pvt Ltd
- vi. Kochar Consultants Pvt Ltd
- vii. Deloitte Touche Tohmatsu India Pvt Ltd
- viii. Ernst & Young Pvt Ltd.
- ix. KPMG



## SECTION - 7: ALGORITHMIC TRADING<sup>32</sup>

### 7.1 Broad Guidelines on Algorithmic Trading

#### Definition

1. Algorithmic Trading - Any order that is generated using automated execution logic shall be known as algorithmic trading.

#### Guidelines to the stock exchanges and the stock brokers

2. Stock exchanges shall ensure the following while permitting algorithmic trading:
  - i. The stock exchange 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 stock brokers. The stock exchange shall continuously study the performance of its systems and, if necessary, undertake system upgradation, including periodic upgradation of its surveillance system, in order to keep pace with the speed of trade and volume of data that may arise through algorithmic trading.
  - ii. In order to ensure maintenance of orderly trading in the market, stock exchange shall put in place effective economic disincentives with regard to high daily order-to-trade ratio of algo orders of the stock broker. Further, the stock exchange shall put in place monitoring systems to identify and initiate measures to impede any possible instances of order flooding by algos.
  - iii. In order to discourage repetitive instances of high daily order-to-trade ratio, stock exchanges shall impose an additional penalty in form of suspension of proprietary trading right of the stock broker for the first trading hour on the next trading day in case a stock broker is penalized for maintaining high daily order-to-trade ratio, provided penalty was imposed on the stock broker on more than ten occasions in the previous thirty trading days.
  - iv. The stock exchange shall ensure that all algorithmic orders are necessarily routed through broker servers located in India and the stock exchange has appropriate risk controls mechanism to address the risk emanating from algorithmic orders and trades. The minimum order-level risk controls shall include the following:
    - a. Price check - The price quoted by the order shall not violate the price bands defined by the exchange for the security. For securities that do not have price

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<sup>32</sup> Circular No. CIR/MRD/DP/09/2012 dated March 30, 2012 and Circular No. CIR/MRD/DP/16/2013 dated May 21, 2013



bands, *dummy filters* shall be brought into effective use to serve as an early warning system to detect sudden surge in prices.

- b. Quantity Limit check - The quantity quoted in the order shall not violate the maximum permissible quantity per order as defined by the exchange for the security.
  - v. In the interest of orderly trading and market integrity, the stock exchange shall put in place a system to identify dysfunctional algos (i.e. algos leading to loop or runaway situation) and take suitable measures, including advising the member, to shut down such algos and remove any outstanding orders in the system that have emanated from such dysfunctional algos. Further, in exigency, the stock exchange should be in a position to shut down the broker's terminal.
  - vi. Terminals of the stock broker that are disabled upon exhaustion of collaterals shall be enabled manually by the stock exchange in accordance with its risk management procedures.
  - vii. The stock exchange may seek details of trading strategies used by the algo for such purposes viz. inquiry, surveillance, investigation, etc.
  - viii. In order to strengthen the surveillance mechanism related to algorithmic trading and prevent market manipulation, stock exchanges are directed to take necessary steps to ensure effective monitoring and surveillance of orders and trades resulting from trading algorithms. Stock exchanges shall periodically review their surveillance arrangements in order to better detect and investigate market manipulation and market disruptions.
  - ix. The stock exchange shall include a report on algorithmic trading on the stock exchange in the Monthly Development Report (MDR) submitted to SEBI inter-alia incorporating turnover details of algorithmic trading, algorithmic trading as percentage of total trading, number of stock brokers / clients using algorithmic trading, action taken in respect of dysfunctional algos, status of grievances, if any, received and processed, etc.
  - x. The stock exchange shall synchronize its system clock with the atomic clock before the start of market such that its clock has precision of atleast one microsecond and accuracy of atleast +/- one millisecond.
3. Stock exchange shall ensure that the stock broker shall provide the facility of algorithmic trading only upon the prior permission of the stock exchange. Stock exchange shall subject the systems of the stock broker to initial conformance tests to ensure that the checks mentioned below are in place and that the stock broker's system facilitate orderly trading and integrity of the securities market. Further, the



stock exchange shall suitably schedule such conformance tests and thereafter, convey the outcome of the test to the stock broker.

For stock brokers already providing algo trading, the stock exchange shall ensure that the risk controls specified in this circular are implemented by the stock broker.

4. The stock brokers that provide the facility of algorithmic trading shall subject their algorithmic trading system to a system audit every six months in order to ensure that the requirements prescribed by SEBI / stock exchanges with regard to algorithmic trading are effectively implemented. Such system audit of algorithmic trading system shall be undertaken by a system auditor who possess any of the following certifications:
  - i. CISA (Certified Information System Auditors) from ISACA;
  - ii. DISA (Post Qualification Certification in Information Systems Audit) from Institute of Chartered Accountants of India (ICAI);
  - iii. CISM (Certified Information Securities Manager) from ISACA;
  - iv. CISSP (Certified Information Systems Security Professional) from International Information Systems Security Certification Consortium, commonly known as (ISC)<sup>2</sup>
5. Deficiencies or issues identified during the process of system audit of trading algorithm / software shall be reported by the stock broker to the stock exchange immediately on completion of the system audit. Further, the stock broker shall take immediate corrective actions to rectify such deficiencies / issues.
6. In case of serious deficiencies / issues or failure of the stock broker to take satisfactory corrective action, the stock exchange shall not allow the stock broker to use the trading software till deficiencies / issues with the trading software are rectified and a satisfactory system audit report is submitted to the stock exchange. Stock exchanges may also consider imposing suitable penalties in case of failure of the stock broker to take satisfactory corrective action to its system within the time-period specified by the stock exchanges. Further, the stock exchange shall subject the stock broker systems to more frequent system audits, if required. . Further, the stock exchange shall subject the stock broker systems to more frequent system audits, if required.
7. The stock broker, desirous of placing orders generated using algos, shall satisfy the stock exchange with regard to the implementation of the following minimum levels of risk controls at its end -



- i. Price check - Algo orders shall not be released in breach of the price bands defined by the exchange for the security.
  - ii. Quantity check - Algo orders shall not be released in breach of the quantity limit as defined by the exchange for the security.
  - iii. Order Value check - Algo orders shall not be released in breach of the 'value per order' as defined by the stock exchanges.
  - iv. Cumulative Open Order Value check - The individual client level cumulative open order value check, may be prescribed by the broker for the clients. Cumulative Open Order Value for a client is the total value of its unexecuted orders released from the stock broker system.
  - v. Automated Execution check - An algo shall account for all executed, un-executed and unconfirmed orders, placed by it before releasing further order(s). Further, the algo system shall have pre-defined parameters for an automatic stoppage in the event of algo execution leading to a loop or a runaway situation.
  - vi. All algorithmic orders are tagged with a unique identifier provided by the stock exchange in order to establish audit trail.
8. 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 algo trading.
9. The stock broker, desirous of placing orders generated using algos, shall submit to the respective stock exchange an undertaking that -
- i. The stock broker has proper procedures, systems and technical capability to carry out trading through the use of algorithms.
  - ii. The stock broker has procedures and arrangements to safeguard algorithms from misuse or unauthorized access.
  - iii. The stock broker has real-time monitoring systems to identify algorithms that may not behave as expected. Stock broker shall keep stock exchange informed of such incidents immediately.
  - iv. The stock broker shall maintain logs of all trading activities to facilitate audit trail. The stock broker shall maintain record of control parameters, orders, trades and data points emanating from trades executed through algorithm trading.
  - v. The stock broker shall inform the stock exchange on any modification or change to the approved algos or systems used for algos.



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10. The stock exchange, if required, shall seek conformance of such modified algo or systems to the requirements specified in the circular.



**SECTION - 8: ANNUAL SYSTEMS AUDIT**

**8.1 Annual System Audit of Stock Exchanges <sup>33</sup>**

- i. The stock exchanges should annually conduct System Audit as per the System Audit Framework. The system audit framework encompasses the System Audit Process, Auditor Selection Norms, Terms of Reference (TOR), and Audit Report Guidelines as per the annexure below.
- ii. The Systems Audit Reports and Compliance Status should be placed before the Governing Board of the Stock Exchanges and the system audit report along with comments of Stock Exchanges should be communicated to SEBI. Further, along with the audit report, Stock Exchanges are advised to submit a declaration from the MD / CEO certifying the security and integrity of their IT Systems.

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<sup>33</sup> Circular No. CIR/MRD/DMS/13/2011 dated November 29, 2011



**Annexure**

**System Audit Framework**  
**Audit Process**

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

1. The Audit shall be conducted according to the Norms, Terms of References (TOR) and Guidelines issued by SEBI.
2. 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.
3. Audit schedule shall be submitted to SEBI at-least 2 months in advance, along with scope of current audit & previous audit.
4. 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
5. 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.
6. 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.
7. Follow-on audit, if any, has to be scheduled within 3 months of the Audit to ensure that the corrective actions have been taken.
8. 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.

**Auditor Selection Norms**

1. 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).
2. 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 Securities 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>.

3. The Auditor should have IT audit/governance frameworks and processes conforming to industry leading practices like CobiT.
4. 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.
5. 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.

#### **Terms of Reference (ToR)**

1. General Controls for Data Center Facilities - It must include
  - > Application access - Segregation of duties, Database & Application access etc.
  - > Maintenance access - Vendor engineers.
  - > Physical access - Permissions, logging, exception reporting & alerts.
  - > Environmental controls - Fire protection, AC monitoring etc.
  - > Fault resolution mechanism.
  - > Folder sharing and Back-up controls - Safeguard critical information on local desktops
  - > Incidences of violations in last year & corrective actions taken
2. Software Change Control - It must include
  - > User awareness
  - > Processing of new feature request
  - > Fault reporting / tracking mechanism & process for resolutions
  - > Testing of New releases / Bug-fixes - Testing process (automation level)
  - > Version Control - History, Change Management process etc.
  - > Development / Test/ Production environment - Segregation
  - > New release in Production - Promotion, Release note approvals
  - > Production issues / disruptions reported during last year & corrective actions taken
3. Data communication / Network controls - It must include
  - > Network Administration - Redundancy, Monitoring, breakdown resolution etc.
  - > WAN Management - Connectivity provisions for business continuity.
  - > Encryption - Router based as well as during transmission
  - > Connection Permissions - Restriction on need to have basis



- > Fallback mechanism - Dial-up connections controls etc.
- > Hardware based Signing Process
- > Incidences of access violations in last year & corrective actions taken
- 4. Security Controls - General office infrastructure - It must include
  - > Security Policy & quality of implementation of the same
  - > LAN security control and monitoring
  - > OS & Database Security controls & monitoring
  - > Internet connection controls - Firewall protection, Intrusion Detection System, Access rights and privileges.
  - > Virus protection - Controls to mitigate the Virus attacks / Outbreaks.
  - > Secured (digitally signed) e-mail with other entities like SEBI, other partners
  - > Email Archival Implementation
  - > Incidences of security violations in last year & corrective actions taken
- 5. Access policy and controls
- 6. Electronic Document controls
- 7. General Access controls
- 8. Performance audit - It must include
  - > Comparison of changes in transaction volumes since previous audit
  - > Review of systems (hardware, software, network) performance over period
  - > Review of the current volumes against the last Performance Test performed
- 9. Business Continuity / Disaster Recovery Facilities - It must include
  - > BCP manual, including Business Impact Analysis, Risk Assessment and DR process
  - > Implementation of policies
  - > Back-up procedures and recovery mechanism using back-ups.
  - > Storage of Back-up (Remote site, DRS etc.)
  - > Redundancy - Equipment, Network, Site etc.
  - > DRS installation and Drills - Management statement on targeted resumption capability (in terms of time required & extent of loss of data)
  - > Evidence of achieving the set targets during the DRS drills in event of various disaster scenarios.
  - > Debrief / review of any actual event when the DR/BCP was invoked during the year
- 10. IT Support & IT Asset Management - It must include
  - > Utilization monitoring - including report of prior year utilization
  - > Capacity planning - including projection of business volumes
  - > IT (S/W, H/W & N/W) Assets, Licenses & maintenance contracts
  - > Insurance
  - > Disposal - Equipment, Media, etc.
- 11. Entity Specific Software
- 12. Any other Item
  - > Electronic Waste Disposal



- > Based upon previous Audit report as well as any other specific information given by SEBI

**Audit Report Guidelines**

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).

For each section - auditors should also provide qualitative input about ways to improve the process, based upon the best practices observed.

The report should also include tabulated data to show NCs / Observations for each Major Area in TOR.

Fully detailed report should be submitted, along with an Executive Summary in tabulated form including following information:

Issue Log Column Heading	Description	Responsibility
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 annual, interview notes, reports <i>etc.</i> )	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 <i>etc.</i>	Auditor
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

The Executive Summary should also include an overall comment from the Auditors to



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**Securities and Exchange Board of India**

indicate if a follow-on audit is required and the time lines of respective corrective action for non-conformities.

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.



## **8.2 Annual System Audit of Stock Brokers<sup>34</sup>**

- i. The stock exchanges should ensure that system audit of stock brokers / trading members are conducted in accordance with the prescribed guidelines enclosed in the annexure of this section.
- ii. 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.
- iii. Stock Exchange should report all major non-compliances / observations of system auditors, broker wise, on a quarterly basis to SEBI.
- iv. For the current year, in case the stock brokers have commenced their annual system audit, they may follow existing annual system audit framework prescribed by exchanges. However, stock brokers who are yet to commence annual system audit should carry out their annual system audit as per the framework given in this circular.

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<sup>34</sup> Circular No. CIR/MRD/DMS/34/2013 dated November 06, 2013



ANNEXURE  
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)**]<sup>35</sup> / **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 I);
  - 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 II)
  - c. **Type III Broker:** Brokers who use Algorithmic Trading facility to trade and who may also be TYPE II Brokers. (ToR attached as Annexure III)
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.

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<sup>35</sup> or other similar trading facilities



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 – IV 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.



**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.



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.



**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-letted 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 verify 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.



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	Audited 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:
  - a. Non-Compliant
  - b. Work In progress
  - c. Observation
  - d. 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.



Rating	Description
<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



**SECTION - 9: BUSINESS CONTINUITY PLAN AND DISASTER RECOVERY**

**9.1 Guidelines for Business Continuity Plan (BCP) and Disaster Recovery (DR) <sup>36</sup>**

- i. The stock exchanges and depositories 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, stock exchanges should have a Near Site (NS) to ensure zero data loss whereas, the depositories should also ensure zero data loss by adopting a suitable mechanism.
- 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.
- 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

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<sup>36</sup> Circular No. CIR/MRD/DMS/12/2012 dated April 13, 2012 and clarification issued vide Circular No. CIR/MRD/ DMS/17/2012 dated June 22, 2012



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. Live Trading sessions from Disaster Recovery (DR) sites<sup>37</sup>

- a) 'Live trading sessions from DR site shall be scheduled for at least two consecutive days in every six months. To start with, the stock exchanges may schedule such 2-day live trading session once a year.
- b) Such live trading sessions from the DR site shall be organized on normal working days (i.e., not on weekends / trading holidays).
- c) Stock exchange may shift its staff to DR site to organise such live trading sessions. However, in the long run, the stock exchange should develop abilities / skills in the DR staff to run live trading session independent of the Primary Data Center (PDC) staff.
- d) Stock exchanges shall include a scenario of intraday shifting from PDC to DR during mock trading sessions in order to demonstrate its preparedness to meet Recovery Time Objective / Recovery Point

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<sup>37</sup> Letter No. OW/28268/2014 dated September 25, 2014



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Objective (RPO) of not more than 4 hours and 30 minutes respectively.

### viii. BCP - DR Policy Document

- a) The BCP - DR policy of stock exchanges and depositories should be well documented covering all areas as mentioned above including disaster escalation hierarchy.
  - b) The stock exchanges should specifically address their preparedness in terms of proper system and infrastructure in case disaster strikes during business hours.
  - c) Stock Exchanges / Depositories / Clearing Houses or Clearing Corporations of Stock Exchanges should also demonstrate their preparedness to handle any issue which may arise due to trading halts in stock exchanges and / or failure or stoppages at other Stock Exchanges / Depositories / Clearing Corporations
  - d) The policy document and subsequent changes / additions / deletions should be approved by Governing Board of the Stock Exchange / Depositories and thereafter communicated to SEBI.
- ix. Considering the above, stock exchanges and depositories are advised to submit their BCP - DR policy to SEBI within 3 months from the date of this circular. Further, they should also ensure that point 1 (vi) (f) mentioned above is also included in scope of system audit as mentioned in the circular no. CIR/MRD/DMS/13/2011 dated November 29, 2011.

These guidelines will be applicable to depositories, stock exchanges having nation-wide terminals and stock exchanges having trading on their own platforms. Further stock exchanges, currently having no trading on their own platforms, will be required to comply with these guidelines before recommencement of trading on their own platforms in terms of Circular No. MRD/DSA/SE/Cir-12/09 dated October 07, 2009.



## SECTION - 10: CYBER SECURITY AND CYBER RESILIENCE

### 10.1 Cyber Security and Cyber Resilience framework for Stock Exchanges and Clearing Corporations<sup>38</sup>

- i. 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.
- ii. Principle 17 of PFMI 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 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.*"

Stock Exchanges and Clearing Corporations (hereafter 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.

- iii. Based on the consultations and recommendations of Technical Advisory Committee TAC, it has been decided to lay down the framework placed at Annexure below that MIIs would be required to comply with regard to cyber security and cyber resilience.

#### Annexure

1. Cyber attacks and threats attempt to compromise the Confidentiality, Integrity and Availability (CIA) of the computer systems, networks and

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<sup>38</sup> Reference: Circular CIR/MRD/DP/13/2015 dated July 06, 2015



databases.<sup>39</sup> Cyber security framework include measures, tools and processes that are intended to prevent cyber attacks and improve cyber resilience. Cyber Resilience is an organisation's ability to prepare and respond to a cyber-attack and to continue operation during, and recover from, a cyber attack.

### **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 atleast 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 Organisation (NTRO), Government of India in the report titled 'Guidelines for Protection of National Critical Information

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<sup>39</sup> 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



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<sup>40</sup> of the stock exchanges and of the clearing corporations and the IT Strategy Committee<sup>41</sup> of the depositories 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.

### **Identify**

11. MII should identify critical assets based on their sensitivity and criticality

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<sup>40</sup>Refer SEBI Circulars SMD/POLICY/Cir-2/98 dated January 14, 1998 and CIR/MRD/DSA/33/2012 dated December 13, 2012.

<sup>41</sup> Refer SEBI CIR/MRD/DMS/ 03 /2014 dated January 21, 2014.



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, alongwith the likelihood of such threats and impact on the business and thereby, deploy controls commensurate to the criticality.

13. MII should also encourage its third-party providers, such as service providers, stock brokers, depository participants, etc. to have similar standards of 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 authorised 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.

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 authorised 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 unauthorised 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 prioritisation 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, atleast 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 unauthorised or malicious activities, unauthorised changes, unauthorised access and unauthorised 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



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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 MII specified vide circular CIR/MRD/DMS/13/2011 dated November 29, 2011 shall be accordingly modified to include audit of implementation of the aforementioned areas.

**End of Annexure**



## SECTION - 11: CO-LOCATION / PROXIMITY HOSTING

### 11.1 Co-location / proximity hosting facility offered by stock exchanges<sup>42</sup>

- i. The facility of co-location or proximity hosting (or by whatever name called) is offered by the stock exchanges to stock brokers and data vendors whereby their trading or data-vending systems are allowed to be located within or at close proximity to the premises of the stock exchanges, and are allowed to connect to the trading platform of stock exchanges through direct and private network.
- ii. Based on the recommendations of SEBI's Technical Advisory Committee (TAC), stock exchanges are advised to follow the guidelines given below, while facilitating co-location / proximity hosting.
- iii. In order to ensure fair and equitable access to the co-location facility, stock exchanges shall:
  - a) provide co-location / proximity hosting in a fair, transparent and equitable manner.
  - b) ensure that all participants who avail co-location / proximity hosting facility have fair and equal access to facilities and data feeds provided by the stock exchange.
  - c) ensure that all stock brokers and data vendors using co-location / proximity hosting experience similar latency with respect to exchange provided infrastructure.
  - d) ensure that the size of the co-located / proximity hosting space is sufficient to accommodate all the stock brokers and data vendors who are desirous of availing the facility.
  - e) provide the flexibility to avail rack space in the co-location / proximity hosting so as to meet the needs of all stock brokers desirous of availing such facility.
  - f) expeditiously decide on the request of the desirous stock brokers / data vendors for availing co-location / proximity hosting and communicate the

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<sup>42</sup> Reference: Circular CIR/MRD/DP/07/2015 dated May 13, 2015



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decision within fifteen working days from the receipt of the request from the stock brokers / data vendors. In case of a rejection, stock exchanges shall also provide reasons in writing to the stock brokers / data vendors.

- g) facilitate stock brokers to receive data feeds from other recognised stock exchanges at the co-location facilities and allow routing of orders to other recognised stock exchanges from the co-location facilities.
  - h) make available on their websites description of the co-location / proximity hosting, including requirements to be fulfilled by stock brokers / data vendors who avail the facility, details on fees / charges associated with the facility, etc.
  - i) publish on their websites suitable quarterly reports on latencies observed at the exchange.
  - j) be able to identify orders emanating from the co-located servers of stock brokers and the resultant trades. Suitable statistics relating to such orders and trades shall be disseminated by the stock exchanges.
- iv. In order to ensure that the facility of co-location / proximity hosting does not compromise integrity and security of the data and trading systems, stock exchanges shall:
- a) implement suitable mechanism to protect their systems and systems of stock brokers and data vendors at co-location / proximity hosting from unauthorized access.
  - b) frame guidelines on access and conduct of the personnel of stock brokers / data vendors in the premises of the stock exchange, including in the co-located space.
  - c) not provide access in any form to the personnel of stock brokers / data vendors to the stock exchange's trading platform and databases.



## SECTION - 12: CAPACITY PLANNING

### 12.1 Capacity planning framework of stock exchanges and clearing corporations<sup>43</sup>

- i. Being critical infrastructure of the securities market, it is imperative for the stock exchanges and clearing corporations to continuously assess and monitor their system capacities. Over the years, stock exchanges and clearing corporations have experienced increase in volumes owing to the growth of the market and have accordingly taken steps to increase capacities of their trading, clearing and settlement infrastructure.
- ii. Stock exchanges and Clearing corporations are advised to ensure the following requirements while planning capacities of their trading, clearing and settlement and risk management related infrastructure:
  - a) The installed capacity shall be at least 1.5 times (1.5x) of the projected peak load.
  - b) The projected peak load shall be calculated for the next 60 days based on the per-second peak load trend of the past 180 days.
  - c) All systems in trading, clearing and settlement ecosystem shall be considered in this process including all technical components such as network, hardware, software, etc., and shall be adequately sized to meet the capacity requirements.
  - d) In case the actual capacity utilisation exceeds 75% of the installed capacity, immediate action shall be taken to enhance the capacity.
- iii. Stock exchanges and clearing corporations shall implement suitable mechanisms, including generation of appropriate alerts, to monitor capacity utilisation on a real-time basis and shall proactively address issues pertaining to their capacity needs.

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<sup>43</sup> Reference: Circular CIR/MRD/DP/17/2015 dated October 08, 2015



**REFERENCE - List of Circular & Letters**

1. Circular No. SMDRP/POLICY/TTA-14072/CIR-23/99 dated July 12, 1999.
2. Circular No. SMD/POLICY CIR-33/99 dated October 15, 1999.
3. Circular No. SMDRP/POLICY/CIR- 06/2000 dated January 31, 2000.
4. Circular No. SMDRP/Policy/Cir-48/2000 dated October 11, 2000.
5. Circular No. SMDRP/POLICY/CIR-56/00 dated December 15, 2000.
6. Circular No. SEBI/SMD/SE/15/2003/29/04 dated April 29, 2003.
7. Circular No. SEBI/MRD/Policy/SE/15864/2003 dated August 21, 2003.
8. Circular No. DNPD/ Cir-9/04 dated February 3, 2004.
9. Circular No. SEBI/MRD/SE/Cir-11/2004 dated February 25, 2004.
10. Ref. No. DNPD/Cir- 22 /04 dated April 01, 2004.
11. Ref. No. DNPD/Cir-23/04 dated April 27, 2004.
12. Ref.No. DNPD/Cir-24/04 dated May 26, 2004 (STP Guidelines).
13. Ref.No. DNPD/Cir-25/04dated June 10, 2004.
14. Ref. No. DNPD/14785/04 dated July 08, 2004.
15. Ref. No. DNPD/Cir-28/04 dated September 28, 2004.
16. Circular No. MRD/DoP/SE/Cir-20/2005 dated September 8, 2005.
17. Circular No. MRD/DoP/SE/Cir- 14/2006 dated September 28, 2006.
18. Circular No. MRD/ DoP/SE/Cir- 7 /2008 dated April 03, 2008.
19. Letter no. MRD/DoP/NSE/129791/2008 dated June 24, 2008.
20. Circular No. MRD/ DoP/SE/Cir- 03 /2009 dated February 20, 2009.
21. Circular No. CIR/MRD/DP/ 25/2010 dated August 27, 2010.
22. Circular No. CIR/MRD/DP/26/2010 dated August 27, 2010.
23. Circular No. CIR/MRD/DP/ 36 /2010 dated December 09, 2010.
24. Letter no MRD/DoP/ST/OW/11982/11 dated April 08, 2011.
25. Circular No. CIR/MRD/DP/8/2011 dated June 30, 2011
26. Circular No. CIR/MRD/DMS/13/2011 dated November 29, 2011.
27. Circular No. CIR/MRD/DP/09/2012 dated March 30, 2012
28. Circular No. CIR/MRD/DMS/12/2012 dated April 13, 2012
29. Circular No. CIR/MRD/ DMS/17/2012 dated June 22, 2012.
30. Circular No. CIR/MRD/DP/20/2012 dated August 02, 2012.
31. Circular No. CIR/MRD/DP/16/2013 dated May 21, 2013.
32. Circular No. CIR/MRD/DP/24/2013 dated August 19, 2013.
33. Circular No. CIR/MRD/DMS/34/2013 dated November 06, 2013.
34. Circular No. CIR/MRD/DP/06/2014 dated February 07, 2014.
35. Circular No. CIR/MRD/DP/07/2014 dated February 11, 2014.
36. Letter No. OW/28268/2014 dated September 26, 2014.



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37. *Circular No. CIR/MRD/DP/07/2015 dated May 13, 2015.*
38. *Circular No. CIR/MRD/DP/13/2015 dated July 06, 2015.*
39. *Circular No. CIR/MRD/DP/17/2015 dated October 08, 2015*