CHAPTER 4: COMPREHENSIVE RISK MANAGEMENT FOR CASH MARKET AND DEBT SEGMENT

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1. RISK MANAGEMENT FRAMEWORK[1]

1.1. Comprehensive Risk Management Framework for the cash market

1.1.1. Overview

The core of the risk management system is the liquid assets deposited by members with the exchange/clearing corporation. These liquid assets shall cover the following four requirements:

a. ***MTM (Mark To Market) Losses:*** Mark to market losses on outstanding settlement obligations of the member.

b. ***VaR Margins:*** Value at risk margins to cover potential losses for 99.9% of the days.

c. ***Extreme Loss Margins:*** Margins to cover the expected loss in situations that lie outside the coverage of the VaR margins.

d. ***Base Minimum Capital:*** Capital required for all risks other than market risk (for example, operational risk and client claims).

At all points of time, the liquid assets of the member shall be adequate to cover all the above four requirements.

1.1.2. Liquid Assets

The acceptable liquid assets and the applicable haircuts are listed below:

Item	Haircut (see Note A)	Limits
	Cash Equivalents	
Cash	0	No limit
Bank fixed deposits	0	No limit
Bank guarantees	0	Limit on exchange's exposure to a single bank (see Note B)
Securities of the Central Government	See Note H	No limit

[1] Circular Nos. MRD/DoP/SE/Cir-07/2005 dated February 23, 2005 and SEBI/HO/MRD2/DCAP/CIR/P/2020/27 dated February 24, 2020

Units of liquid mutual funds or government securities mutual funds (by whatever name called which invest in government securities)	10%	No limit
Other Liquid Assets 1. Cannot be used for mark to market losses (see Note C) 2. Total of Other Liquid Assets cannot exceed total of Cash Equivalents (see Note D)		
Liquid (Group I) Equity Shares (see clause 1.1.3 for classification of equity shares on the basis of liquidity)	Same as the VaR margin for the respective shares (see clause 1.1.8.1 below)	Limit on exchange's exposure to a single issuer (see Note E)
Mutual fund units other than those listed under cash equivalents	Same as the VaR margin for the units computed using the traded price on stock exchange, if available, or else, using the NAV of the unit treating it as a liquid security (see clause 1.1.8.1 below).	
Corporate Bonds[2]	Fixed percentage based or VaR based Haircut. A higher haircut may be considered to cover the expected time frame for liquidation. To begin with the	Not to exceed 10% of the total liquid assets of the clearing member.

[2] Circular No. CIR/MRD/DRMNP/9/2013 dated March 20, 2013

	haircut shall be a minimum of 10%	

Notes:

A. The valuation of the liquid assets shall be done on a daily basis except for the card value which shall be taken on the basis of the last sale or auction.

B. The exchanges shall lay down exposure limits either in rupee terms or as percentage of the Trade Guarantee Fund (TGF)/ Settlement Guarantee Fund (SGF) that can be exposed to a single bank directly or indirectly. The total exposure would include guarantees provided by the bank for itself or for others as well as debt or equity securities of the bank which have been deposited by members towards total liquid assets.

   Not more than 5% of the TGF/SGF or 1% of the total liquid assets deposited with the exchange, whichever is lower, shall be exposed to any single bank which has a net worth of less than Rs 500 Crores and is not rated P1 (or P1+) or equivalent, by a RBI recognized credit rating agency or by a reputed foreign credit rating agency, and not more than 50% of the TGF/SGF or 10% of the total liquid assets deposited with the exchanges, whichever is lower, shall be exposed to all such banks put together.

C. Mark to market losses shall be paid by the member in the form of cash or cash equivalents.

D. Cash equivalents shall be at least 50% of liquid assets. This would imply that Other Liquid Assets in excess of the total Cash Equivalents would not be regarded as part of Total Liquid Assets.

E. The exchanges shall lay down exposure limits either in rupee terms or as percentage of the Trade Guarantee Fund (TGF)/ Settlement Guarantee Fund (SGF) that can be exposed to a single issuer directly or indirectly and in any case the exposure of the TGF/SGF to any single issuer shall not be more than 15% of the total liquid assets forming part of TGF/SGF of the exchange.

F. Acceptance of Fixed Deposit Receipts (FDRs) by Clearing Corporations as Collaterals[3]

   Clearing corporation shall not accept Fixed Deposit Receipts (FDRs) from trading/clearing members as collateral, which are issued by the trading/

[3] Modified vide Circular no. CIR/MRD/DRMNP/65/2016 dated July 15, 2016

clearing member themselves or banks who are associate of trading/clearing member.

Explanation - for this purpose, 'associate' shall have the same meaning as defined under Regulation 2 (1)(b) of SECC Regulations 2018.

G. Haircut on securities of the Central Government[4]

Type and Tenor of Securities	Haircut
Treasury Bills, and Liquid* Government of India Dated Securities having residual maturity of less than 3 years	2%
Liquid* Government of India Dated Securities having residual maturity of more than 3 years	5%
For all other Semi-liquid* and Illiquid* Government of India Dated Securities	10%

[4] Circular no. SEBI/HO/MRD/DRMNP/CIR/P/2019/33 dated February 21, 2019

1.1.3. **Liquidity Categorization of Securities**

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

Group	Trading Frequency (over the previous six months – see Note A)	Impact Cost (over the previous six months – see Note A)
Liquid Securities (Group I)	At least 80% of the days	Less than or equal to 1%
Less Liquid Securities (Group II)	At least 80% of the days	More than 1%
Illiquid Securities (Group III)	Less than 80% of the days	N/A

Notes:

A. For securities that have been listed for less than six months, the trading frequency and the impact cost shall be computed using the entire trading history of the scrip.

1.1.4. **Monthly Review**

The trading frequency and impact cost shall be calculated on the 15th of each month on a rolling basis considering the previous six months for impact cost and previous six months for trading frequency. On the basis of the trading frequency and impact cost so calculated, the securities shall move from one group to another group from the 1st of the next month.

1.1.5. **Categorisation of newly listed securities**

For the first month and till the time of monthly review as mentioned in section 1.1.4, a newly listed stock shall be categorised in that Group where the market capitalization of the newly listed stock exceeds or equals the market capitalization of 80% of the stocks in that particular group. Subsequently, after one month, whenever the next monthly review is carried out, the actual trading frequency and impact cost of the security shall be computed, to determine the liquidity categorization of the security.

In case any corporate action results in a change in ISIN, then the securities bearing the new ISIN shall be treated as newly listed scrip for group categorization.

1.1.6. **Calculation of mean impact cost**

The mean impact cost shall be calculated in the following manner:

1.1.6.1. Impact cost shall be calculated by taking four snapshots in a day from the order book in the past six months. These four snapshots shall be randomly chosen from within four fixed ten-minutes windows spread through the day.

1.1.6.2. The impact cost shall be the percentage price movement caused by an order size of Rs.1 Lakh from the average of the best bid and offer price in the order book snapshot. The impact cost shall be calculated for both, the buy and the sell side in each order book snapshot.

1.1.6.3. The computation of the impact cost adopted by the Exchange shall be disseminated on the website of the exchange.

1.1.6.4. The exchanges shall use a common methodology for carrying out the calculations for mean impact cost. The stock exchanges which are unable to compute the mean impact cost calculations at their exchanges shall use the impact cost calculations of BSE/NSE. Such stock exchanges shall enter into a formal legal agreement with the relevant stock exchanges for liquidating the positions of their members if necessary, on that stock exchange. If a Stock Exchange is unable to compute the mean impact cost of the scrips traded at the Exchange, as well as not been able to enter into a formal arrangement for liquidation of positions, it shall levy margins on the scrips as applicable to Group II or Group III as explained above, as classification between scrips in Group I or Group II would not be possible at that Exchange.

1.1.6.5. The details of calculation methodology and relevant data shall be made available to the public at large through the website of the exchanges. Any change in the methodology for the computation of impact cost shall also be disseminated by the exchange.

1.1.7. **Mark to Market Losses**

Mark to Market Losses shall be collected in the following manner:

1.1.7.1. The Stock Exchanges shall collect the mark to market margin (MTM) from the member/broker before the start of the trading of the next day.

1.1.7.2. The MTM margin shall also be collected/adjusted from/against the cash/cash equivalent component of the liquid net worth deposited with the Exchange.

1.1.7.3. The MTM margin shall be collected on the gross open position of the member. The gross open position for this purpose would mean the gross of all net positions across all the clients of a member including his proprietary position. For this purpose, the position of a client would be netted across his various securities and the positions of all the clients of a broker would be grossed. Further, there would be no netting across two different settlements.

1.1.7.4. There would be no netting off the positions and setoff against MTM profits across 2 rolling settlements i.e. T day and T-1 day. However, for computation of MTM profits/losses for the day, netting or setoff against MTM profits would be permitted.

1.1.7.5. The methodology for computation of MTM margin is also illustrated by way of an example which is placed in Annexure II.

1.1.7.6. The margin so collected shall be released along with the pay-in, including early pay-in of securities.

1.1.8. **VaR Margin**

1.1.8.1. **Computation of VaR Margin**

a. The VaR Margin is a margin intended to cover the largest loss that can be encountered on 99.9% of the days (99.9% Value at Risk).

The VaR Margins are specified as follows for different groups of stocks[5]:

Liquidity Categorization	VaR Margin
Liquid Securities (Group I)	Based on 6σ, subject to minimum of 9%
Less Liquid Securities (Group II)	Based on 6σ, subject to minimum of 21.5%
Illiquid Securities (Group III)	50% if traded at least once per week on any stock exchange; 75% otherwise

1.1.8.2. **VaR Margin rate**[6]

The applicable VaR margin rates shall be updated at least 5 times in a day, which may be carried out by taking the closing price of the previous day at the start of trading and the prices at 11:00 a.m., 12:30 p.m., 2:00 p.m. and at the end of the trading session.

1.1.9. **Extreme Loss Margin**

The term Extreme Loss Margin replaces the terms "exposure limits" and "second line of defence" that have been used hitherto. It covers the expected loss in situations that go beyond those envisaged in the 99% value at risk estimates used in the VaR margin.

1.1.9.1. The Extreme Loss Margin shall be 3.5% for any stock.[7]

1.1.9.2. The Extreme Loss Margin shall be collected/ adjusted against the total liquid assets of the member on a real time basis.

1.1.9.3. The Extreme Loss Margin shall be collected on the gross open position of the member. The gross open position for this purpose would mean the gross of all net positions across all the clients of a member including his proprietary position.

1.1.9.4. For this purpose, there would be no netting of positions across different settlements.

[5] Circular No. SEBI/HO/MRD2/DCAP/CIR/P/2020/27 dated February 24, 2020

[6] Circular No. MRD/DoP/SE/Cir- 6/2006 dated June 16, 2006

[7] Circular No. SEBI/HO/MRD2/DCAP/CIR/P/2020/27 dated February 24, 2020

1.1.9.5. The Extreme Loss Margin so collected shall be released along with the pay-in.

1.1.10. **Collection and reporting of margins by Trading Member (TM) /Clearing Member (CM)[8]**

1.1.10.1. The 'margins' for this purpose shall mean VaR margin, extreme loss margin (ELM), mark to market margin (MTM), delivery margin, special/ additional margin or any other margin as prescribed by the Exchange to be collected by TM/CM from their clients.

1.1.10.2. Collection of VaR Margin[9]

a. The VaR margin shall be collected on an upfront basis by adjusting against the total liquid assets of the member at the time of trade. Collection on T+1 day is not acceptable.

b. The VaR margin shall be collected on the gross open position of the member. The gross open position for this purpose would mean the gross of all net positions across all the clients of a member including his proprietary position.

c. For this purpose, there would be no netting of positions across different settlements.

d. The VaR margin so collected shall be released along with the pay-in, including early pay-in of securities.

1.1.10.3. The TMs/CMs are required to mandatorily collect upfront VaR margins and ELM from their clients. The TMs/CMs will have time till 'T+2' working days to collect margins (except VaR margins and ELM) from their clients. (The clients must ensure that the VaR margins and ELM are paid in advance of trade and other margins are paid as soon as margin calls are made by the Stock Exchanges/TMs/CMs. The period of T+2 days has been allowed to TMs/CMs to collect margin from clients taking into account the practical difficulties often faced by them only for the purpose of levy of penalty and it should not be construed that clients have been allowed 2 days to pay margin due from them.)

1.1.10.4. The TM/CM shall be exempted from collecting upfront margins from the institutional investors carrying out business transactions and in cases where early pay-in of securities is made by the clients.

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[8] Circular No. CIR/HO/MIRSD/DOP/CIR/P/2019/139 dated Nov 19, 2019
[9] Circular No. MRD/DoP/SE/Cir-07/2005 dated February 23, 2005

1.1.10.5. If the TM/CM had collected adequate initial margins from the client to cover the potential losses over time till pay-in, he need not collect MTM from the client.

1.1.10.6. The TMs/CMs shall report to the Stock Exchange on T+5 day the actual short-collection/ non-collection of all margins from clients.

1.1.11. **Framework to Enable Verification of Upfront Collection of Margins[10]**

1.1.11.1. Based on deliberations with the market participants, with an objective to enable uniform verification of upfront collection of margins from clients by TM/ CM and levy of penalty across segments, it has been decided that the Stock Exchanges/ Clearing Corporations shall adopt the framework specified in the Annexure, for the purpose of 'Mechanism for regular monitoring of and penalty for short-collection/ non-collection of margins from clients' in Cash and Derivatives segments, as specified vide section 1.1.13 of this circular, section 9.5 of SEBI master circular for Commodity Derivatives Segment and Section 39 of SEBI master circular for Stock Brokers.

1.1.11.2. It is reiterated that the applicable upfront margins are required to be collected from the clients in advance of the trade. The aforesaid framework specified in the Annexure is only for the purpose of verification of upfront collection of margin and levy of penalty.

Annexure

Framework to Enable Verification of Upfront Collection of Margins

i. Clearing Corporations shall send minimum 4 snapshots of client wise margin requirement to TMs/CMs for them to know the intraday margin requirement per client in each segment. The number of times snapshots need to be sent in a day may be decided by the respective Clearing Corporation depending on market timings subject to a minimum of 4 snapshots in a day. The snapshots would be randomly taken in pre-defined time windows.

[10] Circular No. SEBI/HO/MRD2/DCAP/CIR/P/2020/127 dated July 20, 2020

ii. The client wise margin file provided by the CCs to TMs/CMs shall contain the EOD margin requirements of the client as well as the peak margin requirement of the client, across each of the intra-day snapshots.

iii. The member shall have to report the margin collected from each client, as at EOD and peak margin collected during the day, in the following manner:

   a. EOD margin obligation of the client shall be compared with the respective client margin available with the TM/CM at EOD.

AND

   b. Peak margin obligation of the client, across the snapshots, shall be compared with respective client peak margin available with the TM/CM during the day.

Higher of the shortfall in collection of the margin obligations at (a) and (b) above, shall be considered for levying of penalty as per the extant framework.

iv. The verification of availability of margins with TM/ CM, as at (iii)(a) and (iii)(b) above, shall be done by exchanges/ clearing corporations on a weekly basis by verification of the balances in the books/ ledgers of the TM/ CM in respect of the client.

v. In derivatives segments (including commodity derivatives) EOD margin & Peak margin requirement shall be based on the fixed Beginning of Day (BOD) margin parameters[11]

Phased adoption

The peak margin obligation of client across snapshots, as at (iii)(b) above, shall be adopted in a phased manner, as given below:

- Phase 1 (for 3 months from the date of implementation) - 25% of (Peak margin obligation of the client across the snapshots) shall be

[11] Circular No SEBI/HO/MRD2/DCAP/P/CIR/2022/60 dated May 10,2022 & Circular No SEBI/HO/MRD/MRD-PoD-2/P/CIR/2023/016 dated February 01, 2023

compared with respective client peak margin available with the TM/CM during the day.

- Phase 2 (for subsequent 3 months) - 50% of (Peak margin obligation of the client across the snapshots) shall be compared with respective client peak margin available with the TM/CM during the day.
- Phase 3 (for subsequent 3 months) - 75% of (Peak margin obligation of the client across the snapshots) shall be compared with respective client peak margin available with the TM/CM during the day.
- Phase 4 (subsequently) - 100% of (Peak margin obligation of the client across the snapshots) shall be compared with respective client peak margin available with the TM/CM during the day.

Shortfall in collection of margins, as detailed in Para (iii) above, shall be calculated by taking into consideration the aforesaid phased adoption of peak margin obligation of client. Further, during the aforesaid period of phased adoption, the member should be able to demonstrate that the balance peak margin obligation (i.e., [peak margin obligation of the client across the snapshots] minus [25%/ 50%/ 75% of Peak margin obligation of the client across the snapshots, depending on the phase]) has been funded from the member's own funds and not from any other client.

1.1.12. **Segregation and Monitoring of Collateral at Client Level**[12]

1.1.12.1. In order to further strengthen the mechanism of protection of client collateral from (i) misappropriation/misuse by TM/ CM and (ii)default of TM/CM and/or other clients, SEBI issued a consultation paper on May 10, 2021 requesting market participants to provide their comments/ views on the proposed framework for segregation and monitoring of collateral at client level.

1.1.12.2. Reporting Mechanism by TMs and CMs

With a view to providing visibility of client-wise collateral (for each client) at all levels, viz., TM, CM and Clearing Corporation (CC), a

[12] Circulars SEBI/HO/MRD2_DCAP/CIR/2021/0598 dated July 20, 2021 and SEBI/HO/MRD2/DCAP/P/CIR/2022/0022 dated February 24, 2022

reporting mechanism, covering both cash and non-cash collateral, shall be specified by the CCs. Details in respect of the same are as under:

a. The reporting structure shall entail disaggregated information (segment-wise and asset type wise break-up)of each client collateral in the following manner:

- TM shall report disaggregated information on collaterals upto the level of its clients to the CM.
- CM shall report disaggregated information on collaterals upto the level of clients of TM and proprietary collaterals of the TMs to the Stock Exchanges(SEs)and CCs in respect of each segment

b. The details to be submitted in the report shall essentially cover the following information, in order to provide a holistic view of the entire client collateral at various levels upto the level of CC:

TM → CM	CM → SE & CC
Client collateral received by TM	Client collateral received by TM
Client collateral retained by TM	Client collateral retained by TM
Client collateral placed with CM	Client collateral placed with CM
	Client collateral retained by CM
	Client collateral placed with CC

c. The aforementioned information shall be required to be reported on a daily basis.

d. A web portal facility shall be provided by the CCs/ SEs to allow clients to view aforesaid disaggregated collateral reporting by TM/CM.

1.1.12.3. Collateral Deposit and Allocation

a. In case of securities collateral provided to CC through margin pledge/re-pledge in the Depository system, CC has visibility of the client to whom such securities belong to, and accordingly is able to assign the value of the securities collateral, based on applicable haircut, to that client's account.

b. Similarly, for other forms of collateral placed with the CC, the CCs shall provide a facility to CMs for upfront segment-wise allocation of collateral to a TM/ client or CM's own account. The CCs shall use such collateral allocation information to ensure that the collateral allocated to a client is used towards the margin obligation of that client only.

c. There shall be no change in the procedures pertaining to placing of securities as collateral through the margin pledge/re-pledge mechanism in the Depository system, and this collateral will be identified as belonging to a client or as being proprietary securities of the TM or CM, as the case may be, as per the existing procedures.

d. While depositing other forms of collateral i.e. Cash, Fixed Deposits (FDs), Bank Guarantees (BGs) or Government Securities provided through the SGL/CSGL route, etc, the CM shall allocate these collaterals into proprietary account of CM, and/or proprietary account of any TM clearing through the CM, and/or account of any of the clients (including Custodial Participants (CPs)) clearing through the CM, and/or of any of the clients trading through the TM who in turn is clearing through the CM, segment-wise.

e. In case of such collateral received by the CM from any TM, the CM shall not accept the same without the TM specifying break-up of such collateral into proprietary account of the TM and/or uniquely identified client account. Similarly, the CC shall not accept such collateral without the CM specifying appropriate break-up of such collateral into proprietary account of CM/ proprietary account of TM/ client account. The CM shall ensure that the sum of break-up of such collateral provided by TM is equal to the total value of such collateral provided by TM, and that the allocation of such collateral to any entity as reported to the CC does not exceed the allocation of collateral reported by the TM for that entity.

f. The amount of collateral allocated shall not exceed the amount of collateral received by the TM/CM from the client and reported as such under the reporting mechanism (refer 1.1.12.2), excluding the securities collateral re-pledged to CC through margin pledge mechanism. Further, the sum of client collateral retained by the TM/CM and client collateral passed on to CM/CC shall equal the amount of collateral received by the TM/CM from the client. Also, the allocation of collateral at CC shall not be lower than the amount of collateral (except securities collateral re-pledged to CC) reported

as having been passed on by the CM to the CC. The CC shall have appropriate validations in place in respect of allocations and reporting done by CMs. Further, CMs shall also perform validations at their end in respect of allocations and reporting done by TMs.

g. An illustration is provided at Annexure-1 regarding permitted and non-permitted allocation of collateral.

h. In case of BGs, the TM/CM may consider the unfunded portion of the BG as proprietary collateral. An illustration is provided at Annexure-2.

i. The allocation thus provided by the CM to CC and by TM to CM shall be considered as final by the CC and CM respectively for the purpose of granting exposure and utilization during default.

j. The TM/CM shall ensure that sufficient collateral is allocated to clients to cover their margin requirements. However, if the client margin applicable at the CC for a client in a segment exceeds the collateral allocated to the client plus the securities collateral re-pledged to CC (from that client's account) in the respective segment, then the proprietary collateral of the TM/CM shall be blocked (including re-pledged/pledged securities and allocated collateral). Such margin blocked from the proprietary collateral towards a client's margin shall be deemed to have been the collateral allocated to that client. This provision shall include deemed allocation of TM's proprietary collateral towards client margins and deemed allocation of CM's proprietary collateral towards TM/CP/client margins.

k. The members shall ensure that allocated collateral plus value of securities collateral re-pledged to the CC for a client is at all times greater than or equal to the minimum margin collection requirement for the respective client in the respective segment, since the amount of minimum margin collection requirement for a client may be different from the margin applicable at CC. CCs shall put in place effective deterrent mechanisms (penalty structure) in consultation with SEBI, which shall be applicable in cases where the allocated collateral plus the securities collateral re-pledged to CC in respect of a client, is falling short of minimum margin collection requirement in the respective segment.

l. Information regarding the collateral allocated by the CM shall be made available on a daily basis on the web portal facility to clients to

view disaggregated collateral reporting by TM/CM (refer Para 1.1.12.2 (d)). Further, CC shall also provide a facility to the TMs of the clients to view such collateral allocation to the clients by the CM.

1.1.12.4. Collateral Valuation

a. CMs are required to maintain at least 50% of the total collateral in the form of cash or cash equivalents. At individual client level, a client may have allocation of cash equivalent, less than the value of non-cash collateral provided by the client. In other words, the minimum 50% cash equivalent collateral requirement may not be applied at the client level. For the purpose of monitoring of at least 50% cash-equivalent collateral at the level of CM, the excess cash-equivalent collateral of a client shall not be considered for other client or for proprietary account of TM/CM. However, the excess cash-equivalent collateral of proprietary account of TM/CM can be considered for clients trading/clearing through them, for the purpose of monitoring minimum 50% cash-equivalent requirement.

b. An illustration of the above requirement is provided at **Annexure-3**.

1.1.12.5. Blocking of Margins

a. The procedure for blocking of margins only specifies the order of blocking of collateral available with the CC. There shall be no change in the requirement of collection of upfront margins by the TM/CM. The TM/CM shall be required to ensure that sufficient collateral is allocated to clients to cover their margin requirements (refer Para 1.1.12.3(j) and 1.1.12.3(k)).

b. The terms "Client Collateral", "TM Collateral", "CP Collateral" and "CM Collateral" shall mean the total of the allocated collateral value plus the value of demat securities collateral provided through margin pledge/re-pledge by any individual client, TM, CP and CM respectively to the level of CC. The TM/CM collateral shall mean the proprietary collateral of the TM/CM only and shall not include the collateral of any of their clients.

c. On receipt of a trade from a client account by the CC, the margin shall first be blocked from the value of the client collateral. If the client collateral is not sufficient, the residual margin shall be blocked from the TM proprietary collateral of the TM of such client. If the TM

proprietary collateral is also not sufficient, then the residual margin shall be blocked from the CM proprietary collateral of the CM of such TM.

d. In case of a trade from the proprietary account of a TM, the margin shall first be blocked from the TM proprietary collateral, and in case such collateral is not sufficient, then the residual margin shall be blocked from the CM proprietary collateral.

e. Margins based on trades from proprietary account of the CM shall be blocked from the proprietary collateral of the CM only.

f. An illustration of blocking of margins is provided at **Annexure-4**.

g. For monitoring of the risk reduction mode (90% utilization or such applicable limit), the following procedure shall be adopted:

- TM level risk reduction mode: Client margin in excess of 90% of the client collateral shall be identified for each client under a TM. The total of such client margin in excess of 90% of the client collateral, plus the proprietary TM margin shall be assessed against the TM proprietary collateral for monitoring of TM level risk reduction mode.

- CM level risk reduction mode: Sum of client margin in excess of 90% of the client collateral for each client under a TM plus the proprietary TM margin, in excess of 90% of TM proprietary collateral shall be calculated as TM margin in excess of 90% of TM collateral. Sum of such margin for each TM clearing through a CM, plus sum of client margin in excess of 90% of the client collateral for each client clearing through such CM, plus the proprietary CM margin shall be assessed against the proprietary CM collateral for monitoring of CM level risk reduction mode.

h. An illustration for monitoring of risk reduction mode is provided at **Annexure-5**.

i. In case of CP trades executed by TMs, the margin shall be blocked in the following order- (i) CP collateral through the executing TM, if any, (ii) residual margin from the proprietary collateral of the

executing TM, and (iii) residual margin from the proprietary collateral of the CM of the executing TM. Upon confirmation of such trades by CM of the CP, the margin so blocked prior to the confirmation shall be released, and shall be blocked in the following order- (i) CP collateral through the confirming CM, and (ii) residual margin from the proprietary collateral of the confirming CM. In case of CP trades, the requirement to ensure that sufficient collateral is allocated to clients to cover their margin requirements shall be on the confirming CM. However, if the trade is confirmed under the auto approval facility provided by the CC, then margin shall be directly blocked in the following order- (i) CP collateral through the confirming CM, and (ii) residual margin from the proprietary collateral of the confirming CM.

1.1.12.6. Change of allocation

a. CMs shall be permitted to change the allocation of collateral deposited with the CC, subject to the value allocated to any client not exceeding the value of actual collateral received from that client (excluding the securities collateral re-pledged to CC through margin pledge mechanism). However, such change of allocation shall be permitted subject to adequacy of available collateral with the CC after the change vis-à-vis the margin obligation. An illustration is provided at Annexure-6.

b. CC shall also provide notification of such change of allocation of collateral to the concerned client, in respect of whom the allocation has been changed, pursuant to the change of allocation.

1.1.12.7. Client Margin Reporting

There shall be no change in client margin reporting process.

1.1.12.8. Settlement

There shall be no change in settlement process.

1.1.12.9. Withdrawal of collateral

a. Subject to the CM not being in default and fulfilling all obligations on a going concern basis, the CM may place requests for withdrawal of collateral to the CC.

b. After validation of such requests, if the collateral is found to be releasable, the CC shall release the collateral to the CM. CM may return the collateral to TM/CP/Clients or utilize collateral of the entities who are in default.

c. CC shall also provide notification of such withdrawal of allocation of collateral to the concerned clients, in respect of whom the allocation has been withdrawn, pursuant to the withdrawal of allocation.

1.1.12.10. Default Management Process

The default management process by the CCs in case of default by a CM shall take place in four stages:

- Stage 1: Completion of settlement to non-defaulting CMs
- Stage 2: Portability or immediate return of collateral
- Stage 3: Close-out of positions and provisional appropriation of collateral
- Stage 4: Identification of defaulting clients and final appropriation of collateral

Stage **1: Completion of settlement to non-defaulting CMs**

a. CC shall utilize available financial resources to complete settlement in a timely manner and complete the pay-outs to the non-defaulting members.

Stage **2: Portability or immediate return of collateral**

a. CC shall put in place a mechanism/ process for TMs/clients/CPs of defaulting CM to establish that they are not in default to the defaulting CM and have deposited collateral to the extent of allocation (including deemed allocation). This process shall be completed within a pre-specified time period. On identification of such non-defaulting TMs/clients/CPs, CC shall provide them opportunity for either porting of their positions and collateral to another CM or immediate return of their collateral.

b. Portability of Positions and Collateral:

I. Entities desirous of availing the facility of portability shall be required to have established alternative trading/clearing arrangements with other TMs/CMs other than the defaulting CM.

II. If any pay-out is due to such entities, such pay-out shall be made to the entities. As a result, the amount of such pay-out shall be added to the pay-in shortfall of the defaulting CM.

c. Immediate return of collateral:

I. Collateral of such entities shall only be utilized to the extent of losses due to liquidation of their respective positions, and the remaining collateral shall be returned, along with the pay-out due to such entities, if any. As a result, the amount of such pay-out shall be added to the pay-in shortfall of the defaulting CM.

d. In some circumstances, it may be desirable to liquidate the positions and even the collateral, since both are subject to risks. Under such circumstances, not closing out positions/collateral to allow for portability may lead to accumulation of losses. Considering the nature of positions, market conditions and such other risk assessment, the CC may at any stage decide to not provide the facility of portability. If the CC decides to not provide the opportunity for portability, the CC shall crystalize the profits/losses on close-out of positions and the value of collateral arrived at after liquidation of the same.

Stage 3: Close-out of positions and provisional appropriation of collateral

For the remaining entities after Stage 2, i.e., entities other than the ones who could avail the opportunity of either porting or immediate return of collateral in Stage 2, following process shall be followed:

a. CC shall close out all open positions of the defaulting CM, including the positions of TMs/clients/CPs clearing through such CM.

b. CC shall first utilize the CM/TM/Client/CP collateral for meeting any losses in close-out of respective positions. It is clarified that TM/Client/CP collateral shall include both allocated collateral (including deemed allocated collateral) and the value of securities

collateral provided through margin pledge/re-pledge to the level of CC.

c. In case of any shortfall in collateral of any entity under the CM, any excess proprietary collateral of the TM / CM of such entity shall be used. This shall follow the same order of utilization as in case of blocking of margins. Any shortage in the proprietary collateral of the TM / CM shall be met by applying the default waterfall of the CC.

d. With regard to the defaulted settlement obligations, following process shall be followed:

I. Any pay-out made to the non-defaulting clients in Stage 2 shall be added to the defaulted obligations.

II. The defaulted obligations (including pay-out in Para (i) above) shall be first adjusted with the proprietary obligation of the defaulting CM to the extent of funds/securities payable for the proprietary trades.

- Any shortage in the proprietary collateral of the defaulting CM shall be met by applying the default waterfall of the CC.
- Any excess proprietary collateral of the CM shall also be used for meeting the defaulted obligations.

III. Remaining defaulted obligations shall be attributed pro-rata: funds pay-in shortfall shall be attributed pro-rata among TM/clients/CP having funds payable and securities pay-in shortfall shall be attributed pro-rata among TM/clients/CP having deliverable positions in the security. Such losses shall be recovered from the collateral of the TM/clients/CP available, if any.

  - Any shortage in the collateral of such TM/clients/CP shall be met by applying the default waterfall of the CC.

IV. In case of any defaulted obligations attributed to a TM in Para (iii) above (and in turn to its clients), the process enunciated above at Para (ii) and (iii) above for a defaulting CM and its constituents shall apply, *mutatis mutandis*, to the TM.

e. The aforesaid pro-rata attribution of shortages shall be provisional. The actual attribution of shortages to clients shall be done in Stage-4.

f. In case there is any profit to a TM/client/CP during the close-out process, such close-out profit shall be considered as pay-out due to the TM/client/CP.

An Illustration on the procedures to be followed in the Stage-2 and the Stage-3 are given at **Annexure-7**.

Stage 4: Identification of defaulting clients and final appropriation of collateral

The procedure for verification and settlement of claims of constituents of defaulting CM shall be as follows:

a. The process for identification of defaulting TM/CP/clients and the return of collateral of non-defaulting TM/CP/clients shall be administered by the appropriate committee viz., Member and Core Settlement Guarantee Fund Committee (MCSGFC) of the Exchange or the CC.

b. The amount that can be claimed by the non-defaulting TM/CP/clients from the CC shall be limited to the allocated collateral (including deemed allocated) and the value of securities collateral provided through margin pledge/re-pledge to the level of CC, plus the pay-out (including profit if any during close-out) due to the constituent, less the losses in close-out of positions of the constituent.

c. The MCSGFC of the CC/Exchange shall implement the relevant procedures for verification and settlement of claims of the non-defaulting TM/CP/clients of the defaulting CM.

d. The constituents actually in default shall be identified and the pro-rata attribution of shortages performed in Stage-3 shall be replaced by the actual attribution of shortages. If there has been any excess collateral appropriated at Stage-3 due to pro-rata attribution, such excess appropriation shall be corrected, and the constituents shall be returned the collateral in full along with the pay-out due to such entities. This amount shall be recovered from the constituents who

have higher shortage (pursuant to actual attribution) than the one attributed on pro-rata basis. If such clients do not have sufficient collateral, then the default waterfall of the CC (including its Core Settlement Guarantee Fund (Core SGF), as per the specified order of waterfall) shall be applied.

e. For any collateral of a client retained by TM/CM, and not allocated to that client's account, the Exchange or the CC shall initiate suitable actions before appropriate court of law for liquidating the assets (movable and immovable) of the defaulter member as per the existing provisions. Further, eligible clients will also have the access to compensation from the Investor Protection Fund, as per the existing provisions.

Illustration on procedures to be followed in Stage-4 are provided at **Annexure-8**

1.1.12.11. **Default of TMs to CMs**

The following procedure shall be adopted in case of default of TM to CM:

a. The CM shall continue to meet its obligations towards its other constituents, as well as the CC.

b. The CM shall close-out all open positions of the defaulting TM (including clients under the TM).

c. Under the supervision of the CC, the CM shall appropriate the collateral towards losses. The losses in closing-out open positions and the settlement obligations due from clients of the TM shall be appropriated first from the allocated collateral (as per allocation provided by TM to CM, including deemed allocated) and securities collateral provided through margin pledge/ re-pledge to the level of CM/CC of respective clients. Any residual losses as well as the losses in closing-out open positions and the settlement obligations of the TM proprietary account shall be appropriated from the TM proprietary collateral. In case of TM proprietary collateral being insufficient, the losses shall not be appropriated from any other constituent of the CM or any constituent of the defaulting TM.

d. After the above utilization towards losses in closing-out open positions of the defaulting TM (and clients under the TM) and net

settlement shortfall, all remaining collateral/funds received from the defaulting TM (lying with CM/CC) shall be provided by the CM to the Stock Exchanges.

e. Since the TM will be leading to default, the Stock Exchanges shall institute relevant applicable procedures against the TM as per existing regulatory provisions, byelaws, rules and regulations of the Stock Exchanges.

1.1.12.12. **Violations**

a. Any false allocation by members shall be treated as a violation and disciplinary action shall be taken against the members.

b. The aforementioned framework for segregation and monitoring of collateral at client level shall be applicable to all segments and product classes at Stock Exchanges/ Clearing Corporations.

c. The provisions of the circular no. SEBI/HO/MIRSD/DOP/CIR/P/2020/28 dated February 25, 2020 (Section 41 of SEBI master circular for stock brokers) shall, accordingly, be amended to the extent mentioned above. All other provisions specified in the said circular dated February 25, 2020 shall remain unchanged.

1.1.12.13. Annexures

Annexure-1: Allocation of collateral

Illustration 1:

Consider a self-clearing member (SCM) who has received the following cash collateral from its clients:

Client	**Cash Received (Rs)**
Client-1	2 crore
Client-2	3 crore
Client-3	1 crore
Client-4	1 crore
Total	**7 crore**

The member places Rs 6 crore with the CC – Rs 4 crore out of client funds and Rs 2 crore out of proprietary funds. Rs 3 crore worth of client collateral is maintained in the specified client bank account of the member. Few illustrations of allocations and whether permitted or not are provided below:

Sl.	Allocation		Comments
1	Prop	2 Cr	Permitted, since total Rs 4 cr is allocated among clients and allocations to individual clients do not exceed the respective collateral provided by them.
	Client-1	1 Cr	
	Client-2	1 Cr	
	Client-3	1 Cr	
	Client-4	1 Cr	
2	Prop	2 Cr	Permitted, since total Rs 4 cr is allocated among clients and allocations to individual clients do not exceed the respective collateral provided by them.
	Client-1	2 Cr	
	Client-2	2 Cr	
3	Prop	2 Cr	Permitted, since total Rs 4 cr is allocated among clients and allocations to individual clients do not exceed the respective collateral provided by them.
	Client-2	3 Cr	
	Client-3	0.5 Cr	
	Client-4	0.5 Cr	
4	Prop	3 Cr	Not permitted, client collateral allocated as proprietary. Total collateral received from clients does not equal amount with the member plus amount allocated.
	Client-1	2 Cr	
	Client-3	1 Cr	
5	Prop	2 Cr	Not permitted, allocation to Client-3 is in excess from the collateral received from the client.
	Client-2	2 Cr	
	Client-3	2 Cr	
6	Client-1	2 Cr	Permitted, proprietary collateral can be allocated as client collateral provided the allocated amount does not exceed the actual collateral received from the client.
	Client-2	3 Cr	
	Client-3	0.5 Cr	
	Client-4	0.5 Cr	
7	Client-1	4 Cr	Not permitted, although proprietary collateral can be allocated as client collateral, such collateral cannot exceed the actual collateral received from the client
	Client-3	1 Cr	
	Client-4	1 Cr	

Illustration 2:
Suppose a SCM receives the following collateral from clients:

Client	Collateral Type	Value (Rs)
Client-1	Cash	1 crore
Client-2	Approved securities	2 crore

Client-2	Non-approved securities	2 crore

The member re-pledges the approved securities to the CC. The non-approved securities cannot be provided to the CC. The member provides Rs 1 crore cash collateral of Client-1 and Rs 5 crore proprietary cash collateral to the CC. The member may allocate the collateral as follows:

Client	**Value (Rs)**
Client-1	1 crore
Proprietary	5 crore

Thus, only the collateral provided to the CC (excluding securities provided through the margin pledge mechanism) shall be allocated. To clarify, Client-2 would still get the benefit of eligible securities collateral re-pledged to CC, however the value for the same shall be assigned by the CC to the account of Client-2, and therefore no collateral allocation shall be done by the member. The non-approved securities collateral would be retained by the member.

If the Client-2 wishes to trade in such a manner that the margin would exceed Rs 2 crore, the member may allocate the proprietary collateral to the client, as follows:

Client	**Value (Rs)**
Client-1	1 crore
Client-2	2 crore
Proprietary	3 crore

Annexure-2: Treatment of unfunded portion of BG

Consider an example of a SCM with two clients. Suppose the SCM receives the following cash collateral from each of the clients:

Client	**Cash Received (Rs)**
Client-1	1 crore
Client-2	1 crore

Suppose the SCM provides the cash received to a bank and obtains a Bank Guarantee of Rs. 4 crore and provides it to CC. Then, the CM shall allocate the BG as follows:

Entity	BG Allocation (Rs)
Client-1	1 crore
Client-2	1 crore
SCM – Proprietary	2 crore

Annexure-3: Monitoring of the minimum 50% cash-equivalent collateral requirement

Consider the following example of collateral provided by various entities under a CM.

Entity	Cash-equivalent (A)	Non-cash (B)	Excess cash-eq. If(A>B,A-B,0)	Excess noncash If(B>A,B-A,0)
CM Prop	100	40	60	0
TM-1 Prop	0	0	0	0
TM-1 Cli-1	200	250	0	50
TM-1 Cli-2	70	10	60	0
TM-1 Cli-3	70	100	0	30
TM-2 Prop	300	200	100	0
TM-2 Cli-4	70	90	0	20
TM-2 Cli-5	50	100	0	50

Considering TM-1, the excess cash-equivalent collateral of TM-1 Cli-2 cannot be used to offset the excess non-cash collateral of TM-1 Cli-1 and TM-1 Cli-3. Therefore, there will be excess non-cash collateral to the extent of 80 (50 for Cli-1 and 30 for Cli-3) under TM-1.

Considering TM-2, the excess proprietary cash-equivalent collateral of TM-2 can be used to offset the excess non-cash collateral of TM-2 Cli-4 and TM-2 Cli-5. Therefore, there will be no excess noncash collateral under TM-2.

Summary of excess cash-equivalent and excess non-cash collateral under CM prop, TM-1 and TM-2 would be as under:

Entity	Excess Cash-eq	Excess noncash
CM Prop	60	-
TM-1	-	80
TM-2	30	-

The excess cash-equivalent collateral of TM-2 cannot be used to offset the excess non-cash collateral of TM-1. However, the excess cash-equivalent collateral of CM Prop can be used to offset excess non-cash collateral of TM-1. Therefore, the overall excess non-cash collateral will be 20, for TM-1.

Entity	Excess noncash
TM-1	20

The benefit of this excess non-cash collateral (20) will not be available under TM-1. The entities who will get benefit would be identified through a suitable mechanism by the CCs. In this example, suppose the CC applies FIFO rule and it is assumed that Cli-1 has pledged the non-cash collateral before Cli-3. Therefore, the Cli-1 will receive benefit for its entire collateral (so the effective value of collateral of Cli-1 will be 200+250=450). On the other hand, Cli-3 will not receive benefit of non-cash collateral to the extent of 20 (so the effective value of collateral of Cli-3 will be 70+80 = 150).

Annexure-4: Blocking of margins

Suppose the total collateral (allocated collateral plus securities collateral placed through margin pledge/ re-pledge to CC) available against various entities are as given below.

Entity	Collateral (Rs)
CMTM Prop	1000
TM-1 Prop	500
TM-1 Cli-1	300
TM-1 Cli-2	300

- Trade-1: TM-1 Cli-2 trades with margin requirement of Rs 100. Blocking of margin shall be as follows:

Entity	Collateral (Rs)	Blocking (Rs)
CMTM Prop	1000	0
TM-1 Prop	500	0
TM-1 Cli-1	300	0
TM-1 Cli-2	300	100

- Trade-2: TM-1 Cli-1 trades with margin requirement of Rs 600. Blocking of margin shall be as follows:

Entity	Collateral (Rs)	Blocking (Rs)
CMTM Prop	1000	0
TM-1 Prop	500	300
TM-1 Cli-1	300	300
TM-1 Cli-2	300	100

- Trade-3: TM-1 Cli-2 trades with revised margin requirement for Cli-2 of Rs 600. Blocking of margin shall be as follows:

Entity	Collateral (Rs)	Blocking (Rs)
CMTM Prop	1000	100
TM-1 Prop	500	500
TM-1 Cli-1	300	300
TM-1 Cli-2	300	300

- Trade-4: TM-1 Cli-2 trades with revised margin requirement for Cli-2 of Rs 900. Blocking of margin shall be as follows:

Entity	Collateral (Rs)	Blocking (Rs)
CMTM Prop	1000	400
TM-1 Prop	500	500
TM-1 Cli-1	300	300
TM-1 Cli-2	300	300

In the above examples, the collateral of Rs 500 blocked from the TM1-Prop, and the collateral of Rs 400 blocked from CMTM Prop, shall be deemed to be allocated to TM-1 Cli-1 and TM-1 Cli-2. The deemed allocation would be as follows:

<table>
<tr><th>Client</th><th>Margin (Rs)</th><th>Blocked from client collateral (Rs)</th><th>Deemed allocation from TM-1 Prop (Rs)</th><th>Deemed allocation from CMTM Prop to TM-1 Prop (Rs)</th></tr>
<tr><td>TM-1 Cli-1</td><td>600</td><td>300</td><td>300</td><td rowspan="2">400</td></tr>
<tr><td>TM-1 Cli-2</td><td>900</td><td>300</td><td>600</td></tr>
</table>

To clarify, the deemed allocation from CMTM Prop to TM-1 Prop is Rs 400, therefore the total TM-1 Prop collateral (including deemed allocated) would be Rs 900 (Rs 500 + Rs 400). Out of this, the excess client margin would be considered to be deemed allocated to the respective client.

Annexure-5: Monitoring of risk reduction mode

Suppose the total collateral (allocated collateral plus securities collateral placed through margin pledge/ re-pledge to CC) available against various entities, along with their margin obligations, are as given below.

CM	TM	Client	Collateral (Rs)	Margin (Rs)	CliMrgn>90% (Rs)
CM-1	-	Prop	1200	800	-
CM-1	TM-1	Prop	500	400	-
CM-1	TM-1	Client-1	800	780	60
CM-1	TM-1	Client-2	500	450	0
CM-1	TM-1	Client-3	400	380	20
CM-1	TM-2	Prop	500	200	-
CM-1	TM-2	Client-4	1000	920	20
CM-1	TM-2	Client-5	1000	880	0

TM level monitoring

In the above table, "CliMrgn>90%", or client margin in excess of 90%, has been calculated as margin for the client less 90% of the client collateral. Risk reduction mode monitoring for TM shall be based on assessment of [TM Prop Margin + CliMrgn>90%] against the [TM Prop collateral]. Accordingly, margin utilization percentage of TM1 and TM2 would be as under:

- Margin utilization percentage of TM1 = [400 + (60 + 0 + 20)] /500 = 96%

- Margin utilization percentage of TM2 = [200 + (20 + 0)] /500 = 44%

In other words, for TM1, margin of Rs 30 is in excess of 90% of its prop collateral, while there is no excess margin for TM2 against its prop collateral. The same has been tabulated below:

TM	Total CliMrgn>90% (Rs)	Prop Margin (Rs)	90% of TM prop collateral (Rs)	TMMrgn>90% (Rs)
TM-1	80	400	450	30
TM-2	20	200	450	0

CM level monitoring

In the above table, "TMMrgn>90%", or TM Margin in excess of 90%, has been calculated as [CliMrgn>90% + TM Prop margin] in excess of 90% of TM prop collateral. Risk reduction mode monitoring for CM shall be based on assessment of

[CM Prop Margin + TMMrgn>90%] against the [CM Prop Collateral]. Accordingly, margin utilization percentage of CM1 would be as under:

- Margin utilization percentage of CM1 = [800 + (30 + 0)]/1200 = 69.1%

Annexure-6: Change of allocation

Suppose a SCM has following collateral:

Entity	Cash (Rs)
SCM Prop	200
Cli-1	200
Cli-2	200

Out of the total available cash of Rs 600, suppose the SCM has provided an FDR of Rs 400 to the CC (with Rs 200 cash remaining with the member). Suppose, the FDR provided to the CC is allocated by the SCM as follows. Here, the SCM has chosen not to allocate any collateral to Cli-2 in the total collateral placed with the CC:

Entity	Collateral allocated (Rs)
SCM Prop	200
Cli-1	200

Suppose the margin requirement is as follows:

Entity	Collateral (Rs)	Margin blocked (Rs)
CM Prop	200	160
Cli-1	200	150

<u>Change in allocation: Example 1</u>

The member shall be permitted to change the allocation as follows (i.e. the member chooses to consider the cash retained with it to be as Rs 50 belonging to Cli-1 and Rs 150 belonging to Cli-2):

Entity	Collateral (Rs)
CM Prop	200
Cli-1	150
Cli-2	50

<u>Change in allocation: Example 2</u>
The member shall not be permitted to change the allocation as follows (i.e. the member chooses to consider the cash retained with it to be as Rs 100 belonging to each client):

Entity	Collateral (Rs)
CM Prop	200
Cli-1	100
Cli-2	100

This allocation shall not be permitted since Cli-1 has a margin requirement of Rs 150.

Annexure-7: Procedures to be followed in Stage-2 and Stage-3

Consider an example of a SCM defaulting in the derivatives segment. An illustration of the cash settlement obligations of prop/clients and attribution of shortage is provided below (the available collateral shown against different entities comprises of both allocated collateral (including deemed allocated) and value of demat securities collateral provided through margin pledge/re-pledge to the level of CC):

Entity	(Pay-in)/ Pay-out (Rs)	Collateral (Rs)	Position closeout loss (Rs)	Remaining Collateral (Rs)
Prop	(3 crore)	10 crore	4 crore	6 crore
Client-1	(3 crore)	10 crore	3 crore	7 crore
Client-2	(3 crore)	15 crore	4 crore	11 crore
Client-3	2 crore	15 crore	2 crore	13 crore
Client-4	2 crore	3 crore	1 crore	2 crore
Net Pay-in	**5 crore**			
Shortfall	**5 crore**			

<u>Scenario 1: All pay-out clients establish not being in default</u>

1. Suppose Client-3 and Client-4 establish within the pre-specified time period that they are not in default, do not have debit balance/dues towards the member and have not received the pay-out due.
2. The remaining collateral of Client-3 and Client-4 (Rs 13 crore and Rs 2 crore respectively), along with the pay-out for the clients (Rs 2 crore each), shall be provided to the clients.

3. The settlement shortfall would now be Rs 9 crore (Rs 5 crore shortfall in net pay-in, plus Rs 4 crore of pay-out made to Client-3 and Client-4).
4. The settlement shortfall of Rs 9 crore shall be first adjusted with the SCM proprietary pay-in obligation of Rs 3 crore. Excess remaining proprietary collateral of SCM (Rs 3 crore) shall also be used towards the settlement shortfall.
5. Remaining settlement shortfall of Rs 3 crore shall be attributed pro-rata to clients having pay-in, i.e., settlement shortfall of Rs 1.5 crore each shall be attributed to Client-1 and Client-2 and appropriated from their collateral.

<u>Scenario 2: One pay-out client establishes not being in default</u>

1. Suppose Client-3 establishes within the pre-specified time period of not being in default, not having debit balance/dues towards the member and not having received the pay-out due.
2. The remaining collateral of Client-3 (Rs 13 crore), along with the pay-out (Rs 2 crore), shall be provided to the Client-3.
3. The settlement shortfall would now be Rs 7 crore (Rs 5 crore shortfall in net pay-in, plus Rs 2 crore of pay-out made to Client-3).
4. The settlement shortfall of Rs 7 crore shall be first adjusted with the SCM proprietary pay-in obligation of Rs 3 crore. Excess remaining proprietary collateral of SCM (Rs 3 crore) shall also be used towards the settlement shortfall.
5. Remaining settlement shortfall of Rs 1 crore shall be attributed pro-rata to clients having pay-in, i.e., settlement shortfall of Rs 0.5 crore each shall be attributed to Client-1 and Client-2 and appropriated from their collateral.

<u>Scenario 3: One pay-out client and one pay-in client establish not being in default</u>

1. Suppose Client-1 and Client-3 establish within the pre-specified time period of not being in default, not having debit balance/dues towards the member and not having received the pay-out due, where applicable.
2. The remaining collateral of Client-1 and Client-3 (Rs 7 crore and Rs 13 crore respectively) shall be provided to them. The pay-out due to Client-3 (Rs 2 crore) shall also be provided to Client-3.
3. The settlement shortfall would now be Rs 7 crore (Rs 5 crore shortfall in net pay-in, plus Rs 2 crore of pay-out made to Client-3).
4. The settlement shortfall of Rs 7 crore shall be first adjusted with the SCM proprietary pay-in obligation of Rs 3 crore. Excess remaining proprietary collateral of SCM (Rs 3 crore) shall also be used towards the settlement shortfall.

5. Remaining settlement shortfall of Rs 1 crore shall be attributed to Client-2 (since it is established that Client-1 is not in default, no shortage shall be attributed to Client-1).

Annexure-8: Procedures to be followed in Stage-4

Illustration 1:
Suppose an SCM had no proprietary positions, and the net pay-in obligations were based on five clients. There was a pay-in shortfall of Rs 300, against the net pay-in of Rs 600. Suppose none of the clients could establish within the pre-specified time period of not being in default, not having debit balance/dues towards the member and not having received the pay-out due. Assume there is no position close-out loss. The pay-in shortfall of Rs 300 would be attributed during the Stage 3 on a pro-rata basis from the clients having pay-in obligations. This would be utilized from their available collateral (the available collateral shown against different entities comprises of both allocated collateral (including deemed allocated) and value of securities collateral provided through margin pledge/re-pledge to the level of CC).

Entity	(PI) / PO (Rs)	Collateral (Rs)	Utilized Collateral (Rs)	Remaining Collateral (Rs)
Client-1	150	200	0	200
Client-2	150	100	0	100
Client-3	-300	300	100	200
Client-4	-300	300	100	200
Client-5	-300	300	100	200

Suppose the actual client defaults and position of payables/receivables are identified as follows:

Entity	Findings	Claim
Client-1	Did not receive 150 payout	Pay-out of 150 Return of collateral of 200
Client-2	Did not receive 150 payout	Pay-out of 150 Return of collateral of 100
Client-3	Did not make any pay-in	-
Client-4	Did not make any pay-in	-
Client-5	Had made a pay-in of 300	Return of collateral of 300

Accordingly, the remaining collateral of defaulting clients shall be utilized to fulfil the claims of non-defaulting clients. The additional realization and claim settlement is tabulated below:

Entity	Additional utilization of collateral	Claim Settled

Client-1	-	Pay-out of 150 Return of collateral of 200
Client-2	-	Pay-out of 150 Return of collateral of 100
Client-3	Additional collateral of 200 utilized	-
Client-4	Additional collateral of 200 utilized	-
Client-5	-	Return of collateral of 100 (from realized) Return of collateral of 200 (from remaining)

In the event of the remaining collateral of Client-3 and Client-4 not being sufficient (say, due to excess losses in liquidation of positions), the default waterfall of the CC shall be applied for such losses.

<u>Illustration 2:</u>
The following illustration demonstrates the limit on maximum admissible claim against the collateral at the CC by the TM/clients/CP of the defaulting CM. The CC shall recognize the claim of the clients up to the collateral allocated by the CM, plus the value of securities re-pledged till the level of the CC, plus the collateral deemed to be allocated based on the margin requirement of the client. Some examples are tabulated below:

Entity	Collateral provided to member	Margin	Collateral allocated by member at CC	Value of Securities Re-pledged to CC	Collateral deemed allocated (due to margins)	Maximum Admissible claim against collateral at CC
Client-1	1000	800	700	300	0	1000
Client-2	1000	0	400	600	0	1000
Client-3	1000	0	400	400	0	800
Client-4	1000	800	0	0	800	800
Client-5	1000	0	0	0	0	0
Client-6	0	200	100	0	100	0

In the last example (Client-6), the CM shall not be permitted to allocate collateral or permit client to trade beyond the available collateral. In case of such violations, the claim shall not be admissible, and the collateral (allocated and/or deemed so) shall be treated as proprietary collateral of the CM.

1.1.13. **Short-collection/Non-collection of client margins**[13]

1.1.13.1. Stock Exchanges shall levy following penalty on trading members for short-collection/non-collection of margins:

For each member	
'a'	**Per day penalty as %age of 'a'**
(<Rs 1 lakh) And (< 10% of applicable margin)	0.5
(≥ Rs 1 lakh) Or (≥ 10% of applicable margin)	1.0

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

1.1.13.2. If short/non-collection of margins for a client continues for more than 3 consecutive days, then penalty of 5% of the shortfall amount shall be levied for each day of continued shortfall beyond the 3rd day of shortfall.

1.1.13.3. If short/non-collection of margins for a client takes place for more than 5 days in a month, then penalty of 5% of the shortfall amount shall be levied for each day, during the month, beyond the 5th day of shortfall.

1.1.13.4. Notwithstanding the above, if short collection of margin from clients is caused due to movement of 3% or more in the index (close to close value of Nifty/Sensex for all equity derivatives) and in the underlying currency pair (close to close settlement price of currency futures, in case of all currency derivatives) on a given day, (day T), then, the penalty for short collection shall be imposed only if the shortfall continues to T+2 day.

1.1.13.5. The penalty shall be collected by the Stock Exchange within five days of the last working day of the trading month and credited to its Investor Protection Fund.

1.1.13.6. The margin statement which is forwarded on a daily basis by the broker to the clients shall include a column stating the margin charged by the Exchange/Clearing Corporation.

1.1.13.7. When penalty is being collected by a broker for short collection/ non-collection from a client, then the broker shall provide the relevant supporting documents to the client.

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[13] Circular Nos. CIR/DNPD/7/2011 dated August 10, 2011, and CIR/HO/MIRSD/DOP/CIR/P/2019/139 dated November 19, 2019

1.1.13.8. If TM/ CM collects minimum 20% upfront margin in lieu of VaR and ELM from the client, then penalty for short-collection/ non-collection of margin shall not be applicable. However, it is reiterated that CC shall continue to collect the upfront margin from the TM/ CM based on VaR and ELM.[14]

1.1.13.9. In respect of penalty for non-collection of "other margins" (other than VaR and ELM) on or before T+2 days from clients by TM/ CM, following is clarified:[15]

a. If pay-in (both funds and securities) is made by T+2 working days, the other margins would deemed to have been collected and penalty for short/ non collection of other margins shall not arise.

b. If Early Pay-In of securities has been made to the Clearing Corporation (CC), Then all margins would be deemed to have been collected and penalty or short/ non-collection of margin including other margins shall not arise.

c. If client fails to make pay-in by T+2 working days and TM/ CM do not collect other margins from the client by T+2 working days, the same shall also result in levy of penalty as applicable.

1.1.13.10. Additionally, provisions of section 39 of SEBI master circular for Stock Brokers may be referred to.

1.1.14. **Rationalization of imposition of fines for false/incorrect reporting of margins or non-reporting of margins by TM/CM**[16]

1.1.14.1. The Stock Exchanges and Clearing Corporations, in all segments, in consultation with one another, shall devise a standard framework for imposition of fine on the TM/CM for incorrect/false reporting and non-reporting of margin collected from the clients.

1.1.14.2. Considering the principle of 'proportionality', the fine shall be charged to the member based on the materiality of non-compliance done by the member which may include factors such as number of instances, repeated violations, etc. The amount of fine to be charged upon the member may extend to 100% of such false/incorrectly/non reported amount of margin and/or suspension of trading for appropriate number of days.

1.1.15. **Margining Of Institutional Trades in Cash Market**[17]

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[14] Circular No. SEBI/HO/MIRSD/DOP/CIR/P/2020/146 dated July 31, 2020
[15] Circular No. SEBI/HO/MIRSD/DOP/CIR/P/2020/173 dated September 15, 2020
[16] Circular No. CIR/HO/MIRSD/DOP/CIR/P/2019/88 dated August 01, 2019
[17] Circular No. MRD/DoP/SE/Cir- 06/2008 dated March 19, 2008

All Institutional trades in the cash market would be subject to payment of margins as applicable to transactions of other investors. For this purpose, institutional investors shall include:

a. Foreign Portfolio Investors registered with SEBI.
b. Mutual Funds registered with SEBI.
c. Public Financial Institutions as defined under section 2(72) of the Companies Act, 2013 or any subsequent amendments thereof.
d. Banks, i.e., a banking company as defined under Section 5(1)(c) of the Banking Regulations Act, 1949.
e. Insurance companies registered with Insurance Regulatory and Development Authority of India (IRDAI).
f. Pension Fund regulated by Pension Fund Regulatory and Development Authority (PFRDA)[18].

For T+2 rolling settlement, all institutional trades in the cash market would be margined on a T+1 basis with margin being collected from the custodian upon confirmation of the trade..

1.1.16. **Shortfall of Margins/ Pay-in of funds**

1.1.16.1. Margin shortfall

In case of any shortfall in Margin, the terminals of the broker shall be immediately deactivated

[18] Included vide letter dated May 27, 2009 to Stock Exchanges

1.1.16.2. Pay-in shortfall

i. In cases where the amount of shortage in a settlement for a trading member is in excess of the base minimum capital (BMC) specified, the trading facility of the member shall be withdrawn and the securities pay-out due to the member shall be withheld.
ii. In cases where the amount of shortage exceeds 20% of the BMC but less than the BMC on six occasions within a period of three months, then also the trading facility of the member shall be withdrawn and the securities pay-out due to the member shall be withheld.
iii. Upon recovery of the complete shortages, the member shall be permitted to trade subject to his providing a deposit equivalent to his cumulative funds shortage as the 'funds shortage collateral'. Such deposit shall be kept with the Exchange for a period of ten rolling settlements and shall be released thereafter. Such deposit shall not be available for adjustment against margin liabilities and also not earn any interest. The deposit may be by way of cash, fixed deposit receipts or bank guarantee.

1.1.17. **Margining with respect to Exchange Traded Funds (ETFs)[19]**

1.1.17.1. **Use of VaR Methodology with respect to Exchange Traded Funds**

a. Index ETFs are based on a basket of securities. However, for computing margins on ETFs they are treated at par with stocks and margins that are applicable on stocks are being applied for ETFs.
b. In order to bring efficiency in margining of index ETFs, it has been decided that VaR margin computation for ETFs that track an index shall be computed as 6 sigma, subject to minimum of 6%.[20]
c. The revised margin framework is applicable to ETFs that tracks broad based market indices and does not include ETFs which track sectoral indices.

1.1.17.2. The Extreme Loss Margin shall be 2% for ETFs that track broad based market indices and do not include ETFs which track sectoral indices. [21]

[19] Circular No. CIR/MRD/DP/26/2012 dated September 26, 2012
[20] Circular No. SEBI/HO/MRD2/DCAP/CIR/P/2020/27 dated February 24, 2020
[21] Circular No. SEBI/HO/MRD2/DCAP/CIR/P/2020/27 dated February 24, 2020

1.1.17.3. **Introduction of Cross-Margining facility in respect of offsetting positions in ETFs based on equity indices and constituent stocks.**[22]

a. In order to facilitate efficient use of margin capital by market participants, it has been decided to extend cross margining facility to ETFs based on equity index and its constituent stocks for following off-setting positions in cash market segment, as follows:

a. ETFs and constituent stocks (in the proportion specified for the ETF) to the extent they offset each other,
b. ETFs and constituent stocks futures (in the proportion specified for the ETF) to the extent they offset each other and
c. ETFs and relevant Index Futures to the extent they offset each other.
d. In the event of a suspension on creation/ redemption of the ETF units, the cross-margining benefit shall be withdrawn.

1.1.18. **Base Minimum Capital**

1.1.18.1. **Requirement of Base Minimum Capital for Stock Broker and Trading Member**[23]

a. Stock Brokers in cash, derivative and debt segment and Proprietary Trading Members in debt segment shall maintain BMC based on their risk profiles as specified in table below:[24]

Categories	**BMC Deposit**
Only Proprietary trading without Algorithmic trading (Algo)	Rs 10 Lacs
Trading only on behalf of Client (without proprietary trading) and without Algo	Rs 15 Lacs
Proprietary trading and trading on behalf of Client without Algo	Rs 25 Lacs
All Brokers with Algo	Rs 50 Lacs

[22] Circular No. CIR/MRD/DP/ 26 /2012 dated September 26, 2012
[23] Circular No. MRD/DRMNP/36/2012 dated December 19, 2012
[24] Circular No. CIR/MRD/DRMNP/37/2013 dated December 19, 2013

Explanation: The profiling of members may be explained with the following example – A scenario may arise, wherein, a "stock broker" in cash segment and derivative segment is engaged as a principal doing proprietary trading on cash segment and is also engaged as an agent and transacting only on behalf of the clients in the derivatives segment. Further, the member may not have availed facility for algorithmic trading. In such a case, the profile of such a member shall be assessed as "Proprietary trading and trading on behalf of client without Algo". The applicable BMC deposit for such a member shall be Rs 25 Lacs.

1.1.18.2. This BMC deposit requirement stipulated in the table above is applicable to all stock brokers of exchanges having nation-wide trading terminals.

a. For stock brokers of exchanges not having nation-wide trading terminals, the deposit requirement shall be 40% of the above said BMC deposit requirements.

b. The BMC deposit shall be maintained for meeting contingencies in any segment of the exchange. For brokers having registration for more than one segment of the same exchange, the BMC deposit requirement shall not be additive for such number of segments and shall be the highest applicable BMC deposit, across various segment.

c. No exposure shall be granted against such BMC deposit. The Stock Exchanges shall be permitted to prescribe suitable deposit requirements, over and above the SEBI prescribed norms, based on their perception and evaluation of risks involved.

d. Minimum 50% of the deposit shall be in the form of cash and cash equivalents. The existing guidelines on collateral composition shall continue to remain applicable.

1.1.18.3. **BMC requirement for stock exchanges having average daily turnover of less than Rs. 1 crore**

Stock Exchanges shall maintain the BMC at Rs. 1 lakh if the average daily turnover is less than Rs.1 crore for any three consecutive months.

1.1.18.4. **Refund of excess BMC over Rs. 1 lakh**

The excess of the BMC over Rs 1 lakh may be refunded to the members of the exchange subject to the following conditions:

a. The member has been inactive at the stock exchange for the past 12 months, i.e. he has not carried out any transaction on that stock exchange during the past 12 months.
b. There are no investor complaints pending against the member.
c. There are no arbitration cases pending against the member.
d. The exchange shall retain/deduct/debit from the BMC to be refunded, the amount of any complaints/claims of the investors against the member and for dues crystallized and contingent to the exchange/SEBI arising out of pending arbitration cases, appealed arbitration awards, administrative expenses, SEBI turnover fees, etc.
e. The exchange shall ensure that the member has paid the SEBI turnover fees and has obtained a No-Objection Certificate (NoC) from SEBI in this regard.

1.1.18.5. **Re-enhancement of BMC**

If the average daily turnover of the exchange exceeds the specified level of Rs.1 crore for a period of one month at any time, the exchange shall enhance the requirement of the BMC of the members back to the level as specified in Para 1.1.18.1 above and shall obtain undertaking to this effect from the members.

1.1.19. **Additional Margins**

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

1.1.19.1. Additional risk management measures (like ad-hoc margins) would normally be required only to deal with circumstances that cannot be anticipated or were not anticipated while designing the risk management system. If ad-hoc margins are imposed with any degree of regularity, exchanges should examine whether the circumstances that give rise to such margins can be reasonably anticipated and can therefore be

incorporated into the risk management system mandated by SEBI. Exchanges are encouraged to analyse these situations and bring the matter to the attention of SEBI for further action.

1.1.19.2. Any additional margins that the exchanges may impose shall be based on objective criteria and shall not discriminate between members on the basis of subjective criteria.

1.1.19.3. Transparency is an important regulatory goal and therefore every effort must be made to make the risk management systems fully transparent by disclosing their details to the public.

1.1.19.4. **Additional Margin for highly volatile stock**[25]

a. For securities with intra-day price movement (maximum of [High-Low], [High-Previous Close], [Low-Previous Close]) of more than 10% in the underlying market for 3 or more days in last one month, the minimum total margins shall be equal to the maximum intra-day price movement of the security observed in the underlying market in last one month. The same shall be continued till monthly expiry date of derivative contracts which falls after completion of three months from date of levy.

b. For securities with intra-day price movement (maximum of [High-Low], [High-Previous Close], [Low-Previous Close]) of more than 10% in the underlying market for 10 or more days in last six months, the minimum total margins shall be equal to the maximum intraday price movement of the security observed in the underlying market in last six months. The same shall be continued till monthly expiry date of derivative contracts which falls after completion of one year from date of levy

1.1.20. **Margins from the Client**

Members should have a prudent system of risk management to protect themselves from client default. Margins are likely to be an important element of such a system. The same shall be well documented and be made accessible to the clients and the Stock Exchanges. However, the quantum of these margins and the form and mode of collection are left to the discretion of the members.

[25] Circular No. SEBI/HO/MRD2/DCAP/CIR/P/2020/27 dated February 24, 2020

1.1.21. **Provision of early pay-in.**[26]

1.1.21.1. As regards the transactions executed on behalf of institutional clients in the cash market, it shall be permissible to maintain their entire margin in the form of approved securities with appropriate haircuts as at para 1.1.2 above.

1.1.21.2. Necessary systems shall be put in place to enable early pay-in of funds. In cases where early pay-in of funds is made by the members, the outstanding position to that extent of early pay-in shall not be considered for computing the margin obligations.

1.1.21.3. Necessary systems shall be put in place so as to enable adjustment of the pay-in obligations of the members from the cash component of the liquid assets deposited by them.

Exemptions: In cases where early pay-in of securities is made, the outstanding position to the extent of early pay-in shall not be considered for margin purpose.

1.1.22. **Margin provisions for intra-day crystallised losses** [27]

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

1.1.22.2. If crystallised losses exceed the free collateral available with the Clearing Corporation, then the entity shall be put into risk reduction mode as specified in para 1.1.12.5(g) and para 1.10.4 of this circular.

1.1.22.3. Crystallised losses shall be calculated based on weighted average prices of trades executed.

1.1.22.4. Adjustment of intraday crystallised losses shall not be done from exposure free liquid networth of the clearing member.

[26] Circular No. MRD/DoP/SE/Cir-10/2008 dated April 17, 2008
[27] Circular No. CIR/MRD/DRMNP/008/2018 dated January 08, 2018

1.2. **Risk Management Framework for Dedicated Debt Segment on Stock Exchanges**[28]

1.2.1. The term "corporate bonds" in this section refers to debt securities as defined in the Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008.

1.2.2. **Clearing and Settlement**

1.2.2.1. **Settlement Cycle**: The trades settled on DVP-3 basis in debt segment shall have settlement cycle of T+1. In case of trades settled on DVP-1 basis, Stock exchanges shall have flexibility to settle trades on T+0 or T+1.

1.2.2.2. **Settlement Basis**

a. Retail Market: The Stock Exchanges shall continue to settle trades on DVP-3 basis in retail market of debt segment for publically issued corporate bonds.

b. Institutional market: The Stock exchanges may provide settlement on DVP-3 basis for publicly issued corporate bonds and for such privately placed corporate bonds which meet certain selection/ eligibility criteria to be specified by the exchanges.

c. The minimum selection/eligibility criteria for privately issued corporate bonds to be eligible for DVP-3 settlement shall include the following:

1.2.2.2.c.1. The corporate bonds shall have a minimum rating of AA+ (or similar nomenclature).

1.2.2.2.c.2. The yield spread of corporate bonds over similar residual tenure government securities shall not exceed 150 basis points.

1.2.2.2.c.3. New corporate bonds listed during the month shall also be eligible for DVP-3 settlement if they meet the rating and yield spread criteria stated at 1.2.2.2.c.1 and 1.2.2.2.c.2 above.

1.2.2.2.c.4. In case of existing corporate bonds, only liquid bonds shall be permitted. The stock exchanges may consider one or more following factors while defining liquid bonds:

i. Bonds to have traded for at least 5 trading days in every month (including both exchange trades and reported trades).

[28] Circular No. SEBI/MRD/DP/27/2013 dated September 12, 2013

ii. Bonds to have minimum trading volumes of Rs. 25 crores in every month (including both exchange trades and reported trades).

1.2.2.2.c.5. The list of eligible bonds may be reviewed on monthly basis and made applicable from 15th of subsequent month.

1.2.2.2.c.6. In all other cases, privately issued corporate bonds shall continue to settle on DVP-1 basis.

1.2.3. **Risk Management**

1.2.3.1. The Clearing Corporation shall provide settlement guarantee for trades settled on DVP-3 basis. For this purpose, the Clearing Corporation shall create a Settlement Guarantee Fund on similar lines as in other segments.

1.2.3.2. For the purpose of risk management in respect of trades settled on DVP-3 basis, the Clearing Corporation shall impose the following margins:

a. **Initial Margin (IM)**: Initial margin shall be based on a worst case loss of a portfolio of an individual client across various scenarios of price changes so as to cover a 99% VaR over one day horizon.

b. The minimum initial margin shall be 2% for residual maturity upto three years, 2.5% for residual maturity above three years and up to five years; and 3% for maturity above five years. The margin shall be calculated as percentage of traded price of the bond expressed in terms of clean price i.e. without taking accrued interest into account.

1.2.3.2.b.1. Stock Exchanges may follow a VaR estimation model similar to Interest Rate Futures

1.2.3.2.b.2. The Initial Margin shall be deducted upfront from the liquid assets of the member taking into account gross open positions.

c. **Extreme Loss Margin (ELM):** The ELM shall cover the expected loss in situations that go beyond those envisaged in risk estimates used in the initial margins. The ELM for any bond shall be 2% of the traded price expressed in terms of clean price. It would be deducted upfront from the total liquid assets of the member.

1.2.3.3. **Liquid Assets**: As specified at para 1.1.2 above, The liquid assets for meeting margin requirements may be deposited in the following form:

a. At least 50% in cash or cash equivalents i.e. government securities, bank guarantee, fixed deposits or units of liquid mutual funds or government securities mutual funds;

b. Not more than 50% in the form of corporate bonds/ liquid equity shares/ mutual fund units other than units of liquid mutual funds or government securities mutual funds;

1.2.4. **Auction/financial close-out**[29]: In case of shortages, stock exchanges/clearing corporations may conduct financial close-out . The financial close out shall take place at highest price on Trade date (which becomes the trade price) with a 1% mark-up on trade price.

1.2.5. **Reporting**: The reporting platform made available by stock exchanges under the earlier SEBI circulars shall be merged with the negotiated window or facility for RFQ or other such similar facility provided by debt segment of exchanges for enabling reporting of OTC trades or facilitating OTC trades. This platform shall be available for reporting of trades by both members and non-members.

1.3. Deposit Requirements for Clearing Member (CM)/ Self Clearing Member (SCM) in Debt Segment[30]

1.3.1. **Clearing Member (CM)/ Self Clearing Member (SCM)**: The deposit shall be INR 10 lacs. No exposure shall be granted against such deposit requirement of the Clearing Member/ Self Clearing Member.

1.3.2. **Provided** no deposit shall be payable by entity desirous of being CM/SCM in debt segment, in case, it is already a CM or SCM or stock broker of any other segment of the stock exchange/ clearing corporation.

1.3.3. **Provided further that** no deposit shall be payable in case a CM/ SCM clears and settles trades only on gross basis for both securities and funds, and where no settlement guarantee is provided by the clearing corporation.

[29] Modified vide Circular no. SEBI/HO/MRD/DP/CIR/P/2017/11 dated February 10, 2017
[30] Circular No. MRD/DRMNP/37/2013 dated December 19, 2013

1.4. Risk management framework for Foreign Portfolio Investors (FPI) under the SEBI (Foreign Portfolio Investors) Regulations, 2014[31]

1.4.1. Margining of trades undertaken by FPIs in the Cash Market:

1.4.1.1. For T+2 rolling settlement, the trades of FPIs shall be margined on a T+1 basis.

1.4.1.2. However, the trades of FPIs who are Corporate bodies, Individuals or Family offices shall be margined on an upfront basis as per the extant margining framework for the non-institutional trades.

1.4.2. FPI Facility for allocation of trades -The following framework shall be implemented to facilitate allocation of trades of a FPI to other FPIs:

1.4.2.1. Entities who trade on behalf of FPIs shall inform the stock brokers of the details of FPIs on whose behalf the trades would be undertaken.

1.4.2.2. The stock broker, in turn, shall inform the stock exchanges the details of such related FPIs.

1.4.2.3. Stock exchanges shall put-in place suitable mechanism to ensure that allocation of trade by a FPI is permitted only within such related FPIs.

1.4.3. Custodians/ DDPs shall provide necessary details related to FPIs, including categorisation of FPIs, to the stock exchanges for the purpose of implementing the aforementioned provisions.

[31] Circular No. CIR/MRD/DP/15/2014 dated May 15, 2014

1.5. Methodology for computation of MTM Margin

For a Client A, his MTM profit/ loss would be calculated separately for his positions on T-1 and T day (two different rolling settlements). For the same day positions of the client, his losses in some scrips can be set off/netted against profits of some other scrips. Thus, we would arrive at the MTM loss/profit figures of the two different days T and T-1. These two figures cannot be netted. Any loss will have to be collected and same will not be setoff against profit arising out of positions of the other day.

Thus, as stated above MTM profits/ losses would be computed for each of the clients Client A, Client B, Client C etc. As regards collection of margin from the broker, the MTM would be grossed across all the clients i.e. no setoff of loss of one client with the profit of another client. In other words, only the losses will be added to give the total MTM loss that the broker has to deposit with the exchange.

		T-1 day	T day	Total profit/loss of Client	MTM for broker
Client A	Security X	800	300		
	Security Y	-500	-1200		
	Total	300	-900	-900	
Client B	Security Z	700	-400		
	Security W	-1000	800		
	Total	-300	400	-300	
Client C	Security X	1000	500		

	Security Z	-1500	-800		
	Total	-500	-300	-800	
Client D	Security Y	700	-200		
	Security R	-300	800		
	Total	400	600	1000	
BROKER					-2000

In this example, the broker has to deposit MTM Margin of Rs. 2000.

1.6. **Margins not to exceed the purchase value of a buy transaction**[32]

In case of a buy transaction in cash market, VaR margins, Extreme loss margins and mark to market losses together shall not exceed the purchase value of the transaction. Further, in case of a sale transaction in cash market, the existing practice shall continue viz., VaR margins and Extreme loss margins together shall not exceed the sale value of the transaction and mark to market losses shall also be levied.

1.7. **Collateral deposited by Clients with brokers**[33]

For brokers to maintain proper records of client collateral and to prevent misuse of client collateral, it is advised that:

1.7.1. Brokers should have adequate systems and procedures in place to ensure that client collateral is not used for any purposes other than meeting the respective client's margin requirements/ pay-ins. Brokers should also maintain records to ensure proper audit trail of use of client collateral.

1.7.2. Brokers should further be able to produce the aforesaid records during inspection. The records should include details of:

[32] Circular No. MRD/DoP/SE/Cir-08/2009 dated July 27, 2009
[33] Circular No. MRD/DoP/SE/Cir- 11/2008 dated April 17, 2008

1.7.2.1. Receipt of collateral from client and acknowledgement issued to client on receipt of collateral.

1.7.2.2. Client authorization for deposit of collateral with the exchange/ clearing corporation/ clearing house towards margin

1.7.2.3. Record of deposit of collateral with exchange/ clearing corporation/ clearing house.

1.7.2.4. Record of return of collateral to client.

1.7.2.5. Credit of corporate action benefits to clients.

1.7.3. The records should be periodically reconciled with the actual collateral deposited with the broker.

1.7.4. Brokers should issue a daily statement of collateral utilization to clients which shall include, inter-alia, details of collateral deposited, collateral utilised and collateral status (available balance/ due from client) with break up in terms of cash, Fixed Deposit Receipts (FDRs), Bank Guarantee and securities.

1.7.5. In case of complaints against brokers related to misuse of collateral deposited by clients, exchanges should look into the allegations, conduct inspection of broker if required and based on its findings take necessary action.

1.7.6. In case client collateral is found to be mis-utilised, the broker would attract appropriate deterrent penalty for violation of norms provided under Securities Contract Regulation Act, SEBI Act, SEBI Regulations and circulars, Exchange Byelaws, Rules, Regulations and circulars.

1.8. Securities as margin obligation to be given by way of pledge/re-pledge in the depository system[34]

1.8.1. Refer Section 41 of SEBI master circular for Stock Brokers.

1.9. Securities as collateral for foreign institutional trades in cash market[35]

1.9.1. Reserve Bank of India (RBI) vide A. P. (DIR Series) Circular no. 47 dated April 12, 2010 (latest directions may be referred to) has permitted FPIs to offer domestic Government Securities (acquired by the FPIs in accordance with the provisions of Schedule 5 to Notification No. FEMA 20/2000-RB

[34] Circular No. SEBI/HO/MIRSD/DOP/CIR/P/2020/28 dated February 25, 2020 and Circular no. SEBI/HO/MIRSD/DOP/CIR/P/2020/88 dated May 25,2020

[35] Circular No. CIR/MRD/DP/15/2010 dated April 28, 2010

dated May 3, 2000,(latest FEMA directions may be referred to) as amended from time to time and subject to the overall limits specified by the SEBI from time to time; the current limit being USD 5 billion), and foreign sovereign securities with AAA rating, as collateral to the recognized Stock Exchanges in India, in addition to cash, for their transactions in the cash segment of the market. However, cross-margining of Government Securities (placed as margins by the FPIs for their transactions in the cash segment of the market) shall not be allowed between the cash and the derivative segments of the market.

1.9.2. **Corporate bonds as collateral in cash market**[36]

1.9.2.1. Reserve Bank of India vide RBI/2012-13/439 A.P. (DIR Series) Circular No. 90 dated March 14, 2013 (latest directions may be referred to) has permitted FPIs to use, in addition to already permitted collaterals, their investments in corporate bonds as collateral in the cash segment. FPIs are permitted to offer the following collaterals - government securities, corporate bonds, cash and foreign sovereign securities with AAA ratings, for their transactions in cash segment.

1.9.2.2. Clearing Corporations while enabling the framework for acceptance of corporate bonds as collateral for transactions of any entity in the cash segment shall ensure that:

a. The bonds shall have a rating of AA or above (or with similar rating nomenclature) by recognised credit rating agencies.
b. The bonds shall be in dematerialized form.
c. The bonds shall be treated as part of the non-cash component of the liquid assets of the clearing member and shall not exceed 10% of the total liquid assets of the clearing member.
d. The bonds shall have a fixed percentage based or VaR based haircut. A higher haircut may be considered to cover the expected time frame for liquidation. To begin with the haircut shall be a minimum of 10%.

1.10. **Pre-trade Risk Controls**[37]

1.10.1. It has been decided to specify a framework of dynamic trade based price checks to prevent aberrant orders or uncontrolled trades. As an initial measure, it has been decided that stock exchanges shall implement the measures as given below.

1.10.2. **Order-level checks**

1.10.2.1. Minimum pre-trade risk controls for all categories of orders placed on Stocks, Exchange Traded Funds (ETFs), Index Futures and Stock futures shall be as follows:

[36] Circular No. CIR/MRD/DRMNP/9/2013 dated March 20, 2013
[37] CIR/MRD/DP/34/2012 dated December 13, 2012

1.10.2.2. Value/Quantity Limit per order:

a. Any order with value exceeding Rs. 10 crore per order shall not be accepted by the stock exchange for execution in the normal market.

b. In addition, stock exchange shall ensure that appropriate checks for value and/ or quantity are implemented by the stock brokers based on the respective risk profile of their clients.

1.10.2.3. Cumulative limit on value of unexecuted orders of a stock broker:

a. Vide SEBI circular CIR/MRD/DP/09/2012 dated March 30, 2012, stock exchanges have been directed to ensure that the trading algorithms of the stock brokers have a 'client level cumulative open order value check'.

b. In continuation to the above, stock exchanges are directed to ensure that stock brokers put-in place a mechanism to limit the cumulative value of all unexecuted orders placed from their terminals to below a threshold limit set by the stock brokers. Stock exchanges shall ensure that such limits are effective.

1.10.2.4. Stock exchanges shall enhance monitoring of the operating controls of the stock brokers to ensure implementation of the checks mentioned at point 1.10.2.2.b and 1.10.2.3.babove; and levy deterrent penalty in case any failure is observed at the end of stockbroker in implementing such checks.

1.10.3. **Dynamic Price Bands (earlier called Dummy Filters or Operating Range)**

1.10.3.1. Vide circular dated June 28, 2001, stock exchanges had been advised to implement appropriate individual scrip wise price bands in either direction, for all scrips in the compulsory rolling settlement except for the scrips on which derivatives products are available or scrips included in indices on which derivatives products are available.

For scrips excluded from the requirement of price bands, stock exchanges have implemented a mechanism of dynamic price bands (commonly known as dummy filters or operating range) which prevents acceptance of orders for execution that are placed beyond the price limits set by the stock exchanges. Such dynamic price bands are relaxed by the stock exchanges as and when a market-wide trend is observed in either direction.

1.10.3.2. It has been decided to tighten the initial price threshold of the dynamic price bands. Stock exchange shall set the dynamic price bands at 10% of the previous closing price for the following securities:

a. Stocks on which derivatives products are available,
b. Stocks included in indices on which derivatives products are available,
c. Index futures,
d. Stock futures.

1.10.3.3. Further, in the event of a market trend in either direction, the dynamic price bands shall be relaxed/flexed by the stock exchanges in increments of 5%. Stock exchanges shall frame suitable rules with mutual consultation for such relaxation of dynamic price bands and shall make it known to the market. The dynamic price bands may be flexed only after a cooling-off period of 15 minutes from the time of meeting the existing criteria specified by stock exchanges for flexing. One of the conditions followed by stock exchanges for relaxing the price band is that a minimum of 25 trades should be executed with 5 different UCCs on each side of the trade at or above 9.90% and so on.[38]

1.10.3.4. In addition to above, as a principle, exchanges are advised to implement a dynamic price band formulation that is optimum and prevents occurrence of freak trades while ensuring uninterrupted orderly trading in options contracts. Over and above the above the formulation and associated mechanics of dynamic price band, exchanges may put in place any additional controls to achieve the aforesaid objective and to comply

1.10.4. **Risk Reduction Mode**

1.10.4.1. Stock exchanges shall ensure that the stock brokers are mandatorily put in risk-reduction mode when 90% of the stock broker's collateral available for adjustment against margins gets utilized on account of trades that fall under a margin system. Such risk reduction mode shall include the following:

[38] Press Release No. 18/2020 dated March 20, 2020

a. All unexecuted orders shall be cancelled once stock broker breaches 90% collateral utilization level.

b. Only orders with Immediate or Cancel attribute shall be permitted in this mode.

c. All new orders shall be checked for sufficiency of margins.

d. Non-margined orders shall not be accepted from the stock broker in risk reduction mode.

e. The stock broker shall be moved back to the normal risk management mode as and when the collateral of the stock broker is lower than 90% utilization level.

1.10.4.2. Stock exchanges may prescribe more stringent norms based on their assessment, if desired.

1.11. REFERENCE - List of Circulars

S. No.	Circular/Communication Details
1	Circular Nos. MRD/DoP/SE/Cir-07/2005 dated February 23, 2005
2	Circular No. CIR/MRD/DRMNP/9/2013 dated March 20, 2013
3	Modified vide Circular no. CIR/MRD/DRMNP/65/2016 dated July 15, 2016
4	Circular no. SEBI/HO/MRD/DRMNP/CIR/P/2019/33 dated February 21, 2019
5	Circular No. SEBI/HO/MRD2/DCAP/CIR/P/2020/27 dated February 24, 2020
6	Circular No. MRD/DoP/SE/Cir- 6/2006 dated June 16, 2006
7	Circular No. SEBI/HO/MRD2/DCAP/CIR/P/2020/27 dated February 24, 2020
8	Circular No. CIR/HO/MIRSD/DOP/CIR/P/2019/139 dated Nov 19, 2019
9	Circular No. MRD/DoP/SE/Cir-07/2005 dated February 23, 2005
10	Circular No. SEBI/HO/MRD2/DCAP/CIR/P/2020/127 dated July 20, 2020
11	Circular No SEBI/HO/MRD2/DCAP/P/CIR/2022/60 dated May 10,2022
12	Circulars SEBI/HO/MRD2_DCAP/CIR/2021/0598 dated July 20, 2021
13	Circular Nos. CIR/DNPD/7/2011 dated August 10, 2011
14	Circular No. SEBI/HO/MIRSD/DOP/CIR/P/2020/146 dated July 31, 2020
15	Circular No. SEBI/HO/MIRSD/DOP/CIR/P/2020/173 dated September 15, 2020
16	Circular No. CIR/HO/MIRSD/DOP/CIR/P/2019/88 dated August 01, 2019
17	Circular No. MRD/DoP/SE/Cir- 06/2008 dated March 19, 2008
18	Included vide letter dated May 27, 2009 to Stock Exchanges
19	Circular No. CIR/MRD/DP/26/2012 dated September 26, 2012
20	Circular No. SEBI/HO/MRD2/DCAP/CIR/P/2020/27 dated February 24, 2020
21	Circular No. SEBI/HO/MRD2/DCAP/CIR/P/2020/27 dated February 24, 2020
22	Circular No. CIR/MRD/DP/ 26 /2012 dated September 26, 2012
23	Circular No. MRD/DRMNP/36/2012 dated December 19, 2012
24	Circular No. CIR/MRD/DRMNP/37/2013 dated December 19, 2013
25	Circular No. SEBI/HO/MRD2/DCAP/CIR/P/2020/27 dated February 24, 2020
26	Circular No. MRD/DoP/SE/Cir-10/2008 dated April 17, 2008
27	Circular No. CIR/MRD/DRMNP/008/2018 dated January 08, 2018
28	Circular No. SEBI/MRD/DP/27/2013 dated September 12, 2013
29	Circular No. Modified vide Circular no. SEBI/HO/MRD/DP/CIR/P/2017/11 dated February 10, 2017
30	Circular No. MRD/DRMNP/37/2013 dated December 19, 2013
31	Circular No. CIR/MRD/DP/15/2014 dated May 15, 2014
32	Circular No. MRD/DoP/SE/Cir-08/2009 dated July 27, 2009
33	Circular No. MRD/DoP/SE/Cir- 11/2008 dated April 17, 2008
34	Circular No. SEBI/HO/MIRSD/DOP/CIR/P/2020/28 dated February 25, 2020

35	Circular no. SEBI/HO/MIRSD/DOP/CIR/P/2020/88 dated May 25,2020
36	Circular no. CIR/HO/MIRSD/DOP/CIR/P/2019/139 dated November 19, 2019
37	Circular no. SEBI/HO/MRD2/DCAP/P/CIR/2022/0022 dated February 24, 2022
38	Circular No. SEBI/HO/MRD/MRD-PoD-2/P/CIR/2023/016 dated February 01, 2023
39	Circular No. SEBI/HO/MRD2/DCAP/CIR/P/2020/27 dated February 24, 2020