CIRCULAR

CIR/MRD/DP/34/2012 December 13, 2012

To

All Stock Exchanges.

Dear Sir / Madam,

Sub: Pre-trade Risk Controls

1. SEBI has issued various circulars from time to time to implement risk management in cash market and equity derivatives segments. Stock exchanges have operationalised these measures by putting in place checks to be carried out at their end and by the stock brokers.

2. The recent incidents of erroneous orders have brought to fore certain areas that require additional risk control measures to mitigate disruption of trading at the exchanges.

3. In view of the above, SEBI engaged in a consultative process with the market participants, stock exchanges, its Risk Management Review Committee (RMRC) and Technical Advisory Committee (TAC). Global practices in this regard were also studied.

4. Pursuant to the above, it has been decided to prescribe a framework of dynamic trade based price checks to prevent aberrant orders or uncontrolled trades. These measures would be implemented in phases in order to ensure the Indian stock exchanges deploy latest technology while maintaining adequate controls. As an initial measure, it has been decided that stock exchanges shall implement the measures as given below.

Order-level checks

5. 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:

   5.1. 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.

5.2. <u>Cumulative limit on value of unexecuted orders of a stock broker</u>:

(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 exchange 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.

5.3. Stock exchanges shall enhance monitoring of the operating controls of the stock brokers to ensure implementation of the checks mentioned at point 5.1(b) and 5.2(b) above; and levy deterrent penalty in case any failure is observed at the end of stockbroker in implementing such checks.

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

6. Vide circular no. SMDRPD/Policy/Cir-37/2001 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.

6.1 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.

6.2 Further, in the event of a market trend in either direction, the dynamic price bands shall be relaxed 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.

Risk Reduction Mode

7 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:

(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.

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

9 Stock exchanges are directed to:

(a) take necessary steps to put in place systems for implementation of the circular, including necessary amendments to the relevant bye-laws, rules and regulations, within one month from the issuance of the circular and with atleast one week advance notice to the market;

(b) bring the provisions of this circular to the notice of the stock brokers and also disseminate the same on its website;

(c) communicate to SEBI the status of implementation of the provisions of this circular.

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

Yours faithfully,

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