# MODERN SHARES AND STOCKBROKERS LTD

## RISK MANAGEMENT SYSTEM AND SURVEILLANCE POLICY

Risk Management is an intergral part of any orgationisation. Today a stockbroker has to deal with various kind of risk like credit Risk, Market Risk, default Risk, liquidity Risk etc.. In Securities Market, customers have to be alerted with respect to their obligations, open positions, market conditions, Margin requirements, regulatory requirements and steps initiated by brokers in case of changing market situations. With a view to enhance customer knowledge and safeguarding investor interests, the Company – Modern Shares and Stockbrokers Limited (MSSL) has devised a comprehensive Risk Management & Surveillance (RMS) Policy to make sure that customers are aware of Risk and the management of it based on which MSSL monitors risks and initiates actions to safeguard the interests of both the Company and the clients. The Business model for MSSL consist both MSSL and Sub-Brokers.

**Major Functions of RMS :**

- Allocating exposure to the clients' trading account and enabling the clients' to do trades.
- Monitoring of orders & trades by clients. Checking of order rejections and increasing exposure, if required.
- Monitoring the MTM profit/loss incurred out of trades, comparing the Actual Margin requirements of clients and the Total Margin available for clients on a one to one basis and initiating remedial actions, if required.
- Decision taking with regard to squaring off positions on account of MTM loss or Margin shortfalls or any other reasons that may come across.

In MSSL, the Head of Operations is in charge of Surveillance. Activities which contain high risk and complications are to be put forward to the notice of Head of Operations and proper guidance should be taken before executing any action on such activities. MSSL classifies clients into High Risk Profile, Medium Risk Profile and Low Risk Profile. Such classification is done based on a personal relationship maintained with clients. Apart from this, all the clients are evaluated based on the initial margin and subsequent margins paid by them. The trading patterns of clients are also taken into consideration for classification of risk profile.

**TRADING :**

MSSL is a registered stock broker of The National Stock Exchange of India Ltd. (NSE) and The Bombay Stock Exchange (BSE). Both these exchanges follow online trading system and having a settlement system of T+2 in Capital Market segment and Daily mark to market settlement & Final settlement in Futures & Options segment. MSSL is using **Tradis** software (by 3i Infotech Ltd.) for trading in Capital Market and Derivatives segment. The software is widely accepted amongst the industry as whole and is used by several other broking companies across the country.

Both exchanges fix a minimum initial deposit to be maintained by every trading members as initial margin (Base Minimum Capital) and trading members, at their discretion, can have more deposits (Additional Base Capital) to be used as Margin for the purpose of enabling the trading activities. The exposure levels set by these exchanges are on a member level and not on client level.

The Exchanges provide user id for Exchange Trading terminals. Exposures on the CTCL terminal are set by MSSL for each and every client based on the margin available with them.

**EXPOSURE RULES :**

Each and every client registered with MSSL needs to provide initial deposit by way of cheque. On clearance of the cheque the client will be able to put buy or sell orders through MSSL's trading platform. The term 'Exposure' means the extent to which the client's initial deposit can be utilized for trading activities. Exposure for trading is TEN times of the initial deposit. The multiplier in the said example is TEN times. In simple terms, if a client having Rs.100 deposit is allowed to trade for Rs.1000.

MSSL has different exposure policy for Investors and day traders. For an investor, MSSL is providing a 2.5 to 4 times exposure for taking delivery positions in Capital Market. For e.g.: If a client is having Rs.100000/ in his account as clear funds, he is allowed to take a delivery position up to Rs.250000/ to Rs.400000/. The difference amount needs to be brought in the form of a cheque on the same day itself or latest by T+1 day.

A day trader is provided with 8 to 10 times exposure for indulging in day trading activities. This may vary from time to time in accordance with the market conditions. The positions taken for intra-day should be cleared by 3.15 PM on the same day. Once the MTM loss of the intra-day positions reach 75% of the margin available, the client will be cautioned of the positions and will be required to be cleared, failing which the positions taken for the intra-day will be cleared off by the trading department. Intra-day exposure in Capital Market Segment can be availed based on the shares in the Margin Account subject to a 20% haircut in the valuation and with available credit balance in the account.

The exposure set in Capital Market segment and Futures & options segment is different. In capital market the client is allowed to take the exposure on multiplier basis which can be anywhere up to 10 times of initial deposit. Whereas, in Futures & options segment, where exchanges have stipulated fixed initial margins and exposure margin, it is compulsory to keep 100% margin either in the form of clear fund balance or as collateral securities. The term clear fund (Total Margin Available) means the account balance available for the client in his ledger account. Collateral shares means the share which are bought by the client in respect of which no payments are outstanding and are available in the margin account of the client. For availing the benefit of collateral margin, client needs to transfer the shares to margin account maintained in the name of Modern Shares and Stockbrokers Ltd – Margin Account. All the shares transferred as collateral can be considered for exposure after deducting a haircut of 20% to 25% on the closing price of the shares. In short, the total margin for exposure purpose is the sum total of fund balance + 80% of the value of shares available in the Margin Account. Uncleared funds will not be considered for calculating the Total Margin available.

As a conclusion, clients are provided with an exposure of either 2.5 to 4 times delivery margin or 8 to 10 times intra-day margin in Capital Market segment or 1 times Futures & options margin.

**Notes to the Exposure rules :**

1. Uncleared Funds: Every payment from clients should be <u>only</u> in the form of cheque and the same will be considered for margin only after clearance of the instrument. There will not be any exposure provided to clients based on the uncleared funds.
2. However, based on the client's previous track record and the value of collaterals available with

MSSL, exposure can be provided to clients based on uncleared funds after a thorough evaluation of the client's track record, previous instances of cheque dishonours, if any.

3. Outstation cheques are not entertained . All the cheques collected against trading positions should carry a valid MICR number.

All the cheque dishonour cases are viewed seriously. The normal rule for 5 days debit will not be applicable while selling the shares in cheque dishonour issues.

**DEBIT Policy :**

Exchanges follow a settlement schedule of T+2 in Capital Market segment, daily MtoM settlement & Final Settlement in Derivatives segment. Accordingly, the exposure policy designed by MSSL directing the customers to pay the debit balance on the day of purchase itself or on next day. The left out clients' debit will not be allowed to carry forward beyond 5 days. No extension is possible beyond 5 days in whatsoever circumstances. All the requests with genuine reasons for retaining debit up to 5 days shall be considered only after getting approval from Head of Operations.

A client's debit to collateral ratio should be always be in a ratio of 3:4. For a debit of Rs.3/ there should be a minimum collateral valuation of Rs.4/. Any decrease in the collateral valuation will lead to realisation of funds by selling of shares so that the minimum debit to collateral ratio is maintained.

**Futures & options Segment**

In this segment, the exchanges stipulate that every position taken should be based on the available initial margin. Apart from the initial margin, exchanges have introduced exposure margin in order to meet the market volatility and risk associated. Based on the requirements of exchanges, MSSL insists that all the clients in F&O segment should have sufficient margins (Initial + Exposure margin) for taking position in the F&O segment. The margin should either be clear credit balance or in the form of exchange approved collaterals or shares duly transferred to Margin Account or as a combination of these three. The nominal hair cut of 20% to 25% is applicable for collaterals in the form of shares before taking the valuation.

The MTM loss arising in F&O positions need to be paid on the same day (T day) so that MTM settlement can be performed properly, failing which the positions will be reduced to the available margin level. No fresh positions will be granted against unclear cheque. MSSL will reduce the positions if the MTM loss incurred on a day is more than 40% of the actual margin requirement. In order to retain the position in such cases is possible only if Funds are transferred from the client's bank account either through online banking or Fund Transfer.

Clients can provide margin in the form of securities only by transferring the securities to margin account. In such cases also sufficient credit balance should be maintained in client's trading account in order to meet the daily MTM requirements. MSSL stipulates that minimum 10% of the total margin should be in the form of clear credit (Cash component should be 10%). If the cash component is not sufficient to meet the MTM, the shares given as margin will be liquidated to bring the position to required margin level on T+1 day.

**Special Points relating to Options segment :**

1. Options buying should be allowed only against premium margin which should be in the form of clear credit balance only. Collaterals, in any form, will not be considered as margin for options buying.
2. Options selling involve unlimited risk and thereby Exchanges specify high initial margin & exposure margin and hence will be allowed only against the exchange specified margin. Deep out of the money options selling will not be entertained and similarly options having lesser activities will not be allowed. The credit realizing from selling of options will not be considered as liquid credit balance.

**Securities under Ban Period- [Market-wide Position Limit (MWPL)] :**

A facility is available on the trading system to display an alert once the open interest in the futures and options contract in a security exceeds 60% of the market wide position limits specified for such security. Such alerts are presently displayed at time intervals of 10 minutes. The aggregate open interest of the security across Exchanges shall be considered for the purpose of monitoring of MWPL. If the aggregate open interest of the security across exchanges exceeds 95% of the MWPL, no fresh positions shall be permitted for the said security from the subsequent trading day. The normal trading in the security shall be resumed only after the aggregate open outstanding position across Exchanges comes down to 80% or below of the MWPL. Once a client is taking any further position in the security for which MWPL has crossed 95% will be penalized with the amount of penalty as fixed by the exchanges. Hence, the responsibility of informing the clients regarding the MWPL limits is primarily vested with the dealer in charge.

**Trading in Newly Listed Shares & Illiquid Securities :**

Newly listed shares, illiquid securities and Trade-to-Trade shares having high VaR margin and trading in these scrips are subject to the high market risks and rate fluctuations. Illiquid securities & Trade-to-Trade securities will have a daily price range and there are chances that these shares reach the upper DPR or Lower DPR during a trading day. Hence, the dealing in these securities will be subject to the permission from the Head of the Operations and will be subject to the available credit balance only.

Newly listed shares usually do not have any DPR and hence, the chances for rate fluctuations are more. The dealing in newly listed shares will be restricted to the available credit balance after considering the MtoM levels.

**Internet Based Trading (IBT) :**

MSSL do not provide internet based trading facility for its clients.

**Client Code Modification :**

Genuine errors in client codes occurred while punching the orders can be modified subject to the approval from exchanges. The timeline fixed by exchanges have to be met and the other guidelines also need to be followed.

Every request for client code modification is to be sent to Compliance Officer & Head of Operations in the predefined format and proper care should be taken in filling the Exchange order number, trade number and the reasons for wrong Punching. On evaluation of the trades and the clients' financial position with MSSL, the Head of Operations will decide whether to accept the Modification Request or not. Client code modification request will be solely upon the decision of the Compliance Officer & Head of Operations. Physical Contract notes will be sent to such clients on the next day.

## ANNEXURES TO SURVEILLANCE POLICY

### ANNEXURE-I Exposure Policy in Brief

**Capital Market segment :**

1. Clear Funds (Total Margin Available) consists of Ledger Balance and the value of shares in Pool Account & Margin Account subject to a 20% haircut.
2. Uncleared funds will not be considered for calculating Total margin Available.
3. Intraday Exposure will be fixed in between 7-10 times of the Total Margin Available. Maximum intraday exposure will be 10 times of the Total Margin Available.
4. Delivery Exposure will be 2.5 to 4 times of the ledger balance available.
5. Intraday square off should be made before 3.15 PM.
6. Positions taken as intraday can be converted to Delivery subject to the availability of credit balance or on confirmation of Fund transfer.
7. Payment should be collected from clients on T day itself so that the cheques are cleared before 5th day.
8. No outstation cheque will be entertained for meeting the obligations due to trading activities.
9. Demand Draft will be accepted only on unavoidable circumstances as frequent payment by way of DD may come under the purview of PMLA Act and need to report to Government departments. Demand Draft, if any, should be accompanied by a DD declaration in the format prescribed by the Accounts Dept and should be signed by the client and declaration should clearly narrate the reason for not providing a cheque.
10. Minimum range of debit to collateral ratio to be maintained is 3:4.

**Futures & options Segment :**

1. Total Margin Available consists of ledger balance and the value of shares provided as Collaterals in Margin account subject to a 20 % haircut.
2. Uncleared funds will not be considered for calculating Total Margin Available.
3. Positions will be allowed only against Sufficient Margin.
4. All the MtoM losses should be either replenished by way of cheque failing which the positions will be cleared from surveillance Dept. Positions having MtoM loss beyond 40% will not be allowed to carry forward. Carry forward of such positions will be allowed only against successful fund transfer of amounts at least equal to the MtoM loss.
5. No outstation cheque will be entertained for meeting the obligations due to trading activities.

## ANNEXURE-II

**Notes to the Exposure Rules :**

1. Deviations from the standard policy, if any, should get approval from the Head of Operations
2. Debits beyond Five days should be cleared and no leniency is to be given under any circumstances.
3. Margin Shortage in F&O is to be cleared on the day of incurring shortage. MTM loss up to 25 % can be retained on a condition that funds are to be replenished on T+1 date failing which the positions will be reduced on the T+1 day.
4. Extreme care is taken while drafting the exposure policy. Even then, the chances for losses may arise in clients' accounts due to the high variation in security prices on reaching DPR levels. The chances are that once a client initiates a short position in a security and the share may get the upper DPR level and the client could not close out the short position. In such case the chances of incurring auction loss is higher and chances for incurring such instances is existing in the market. Similarly a client goes on a Long position in a security and the chances that the shares price reaches the lower DPR on T day and coming days are there in the market. In these instances, the losses are inevitable and the recovery of funds depends on the relationship of the branch team and the client concerned.