भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

CIRCULAR

SEBI/HO/MIRSD/DPIEA/CIR/P/2020/115 **July 01, 2020**

To

All Recognised Stock Exchanges
All Recognised Clearing Corporations
All Depositories

Madam / Sir,

Subject: Standard Operating Procedure in the cases of Trading Member / Clearing Member leading to default

1. SEBI vide circular dated December 17, 2018 had specified Early Warning Mechanism to prevent diversion of client's securities and consequential action(s) to be initiated by the Stock Exchanges ("SEs"), Clearing Corporations ("CCs") and Depositories were also specified in the said Circular.

2. With the introduction of uniform membership structure of Trading Member ("TM") and Clearing Member ("CM") across all segments, the TM shall make good the default of its clients to the CM and the CM shall make good the default of its clients / TM to the CC. The default of TM may not necessarily lead to default of CM, if the CM continues to fulfill the settlement obligation with the CC. To protect the interest of non-defaulting clients of a TM and /or non-defaulting clients / TM(s) of the CM, in the likely event of default by TM / CM, there is a need for Standard Operating Procedure ("SoP") enumerating the steps to be taken by the SEs / CCs / Depositories in such cases where SE / CC is of the view that TM / CM is likely to default in repayment of funds or securities to its clients.

3. In order to harmonize the action amongst all SEs / CCs / Depositories in a time bound manner this SoP has been prepared in consultation with SEs, CCs and Depositories so as to achieve uniformity in implementation of actions. The SoP lays down the actions to be initiated by the SEs / CCs / Depositories within a time frame after detection of the early warning signals as laid out in the Circular dated December 17, 2018 and other triggers as laid down in this circular untill declaration of defaulter of TM / CM by the SE / CC. Once the TM is declared defaulter, the proceedings shall be in compliance with the bye-laws, rules and regulations of SE / CC respectively.

4. On analysis of early warning signals or any of the following triggers, if the SE / CC is of the view that the TM / CM is likely to default in the repayment of funds / securities to its clients and / or fail to meet the settlement obligations to CM / CC, where:
    a) There is shortage of funds / securities payable to the clients by Rs. 10 crore (SE may have their own criteria) and / or
    b) TM / CM has failed to meet the settlement obligations to CM / CC and / or

c) There is sudden increase in the number of investor's complaints against the TM / CM for non-payment of funds and / or transfer of securities,

the following actions shall be taken by Initiating Stock Exchange (ISE) / SEs / CCs and Depositories as per the timeline given below:

Sr. No.	Action	Timeline
4.1	Seek documents / explanation or Meeting with designated directors of TM.	Within 3 trading days of trigger
4.2	A limited purpose joint inspection of TM shall be initiated. ISE along with other SEs shall send a team of officials for taking possession of the copy of the books of accounts and other relevant records including but not restricted to securities register, trial balance, client master, bank books, debtors and creditors ledger (preferably in electronic mode) for the last 3 years (if available).	Within 3 trading days of the meeting / explanation with the designated directors
4.3	a) The explanations offered by the designated director(s) of the TM shall be analysed by the ISE and based on the information available, to protect the interest of non-defaulting clients, as an interim measure, the trading terminal of the TM may be directed to be disabled by the Managing Director of the ISE for reasons to be recorded in writing. b) A preliminary assessment of assets and liabilities of the TM shall be completed by the ISE.	Within 7 trading days of 4.2
4.4	ISE shall issue a notice / circular informing the disablement of the TM in all segments.	Within 1 day of disablement
4.5	ISE shall communicate the decision of disablement of the trading terminal(s) of the TM along with detailed reasons for disablement to the TM and CM(s) with an advice to CM(s) to square-off open positions of TM and its clients.	Within 1 trading day of disablement
4.6	ISE shall inform the Depositories about the disablement immediately and advice Depositories to freeze the demat accounts of the TM (including TM Pool Accounts). (ISE shall give specific instructions along with PAN to the Depositories). Any debit in the demat account of TM shall be made under supervision of ISE.	Within 1 trading day of disablement
4.7	ISE shall inform other SEs about the disablement immediately and the other SEs shall disable the said TM on receipt of information and the other SEs shall Issue a notice / circular in this regard.	Within 1 trading day of receipt of intimation of disablement from ISE
4.8	TM may also stand suspended to act as a client with any other TM / CM in any other segment / SEs.	Within 1 trading day of the date

		of receipt of information of disablement from ISE
4.9	In case of open positions of clients / TM, CM shall liquidate / square off the open positions.	Within 15 trading days from the date of receipt of information by the CM.
4.10	a) All SEs shall immediately direct other TM / CM so as not to alienate the unencumbered surplus funds / securities held by them for such TM registered as a client. b) CM shall invoke the BGs of TM and all unencumbered funds of TM to be transferred to SE on demand. CM shall also ensure that the BG do not expire in the intervening period else they shall invoke even before the receipt of instructions from SE.	Within 1 trading day of the date of receipt of information of disablement from ISE Upon instructions from SE
4.11	All SEs shall inform the CM / CC regarding pay-out proceeds due to the TM which shall be credited to the settlement account of the TM.	As and when payout is made
4.12	If the open position of clients of TM could not be liquidated / squared off, the re-pledged securities of the client of the TM lying with the CM in the Client Securities Margin Pledge Account and other identifiable collateral of the client of TM such as cash / Bank Guarantee (BG) / Fixed Deposit Receipts (FDR) / Mutual Fund Units shall be taken / encashed over by CM wherever possible in accordance with guidelines issued in this regard from time to time.	Within 15 trading days from the date of receipt of information by the CM
4.13	All the securities lying in client unpaid securities account of the TM (CUSA) shall be liquidated by CM / CC / ISE and the sale proceeds shall be credited to respective client's financial ledger. In this situation depository shall not levy any penalty on such transactions.	Within 15 trading days from receipt of information of disablement from ISE
4.14	a) ISE, in consultation with SEs / CCs, shall appoint a forensic auditor to conduct forensic audit of books of accounts of the concerned TM. All SEs shall obtain details of the free securities / collateral available with their respective CM and CC and provide to the forensic auditor. b) An assessment of assets and liabilities of the TM shall be undertaken by the forensic auditor. The	Within 15 trading days of disablement Within 3 weeks of appointment

	liabilities to the clients for funds and securities shall be established with demarcation of securities belonging to the fully paid clients or partly paid / unpaid clients.	of forensic auditor
4.15	ISE shall also provide a report to SEBI on the reasons for trigger, the meetings held with directors of the TM / CM and the outcomes of limited purpose inspection, the details of actions taken and proposed to be taken under the SoP and any other information that the ISE may deem relevant.	Within 30 trading days from the date of trigger
Action by Depositories		
4.16	Depositories to freeze the demat accounts of the TM (including TM Pool Accounts).	Within 1 trading day from the receipt of information of disablement
4.17	Depositories shall not allow new account opening by the DP (Defaulting TM / CM) and shall suspend all Power of Attorney in favour of the defaulting TM given by its clients.	Within 1 trading days from the date of receipt of information of disablement
4.18	If the TM is also a Depository Participant (DP), the Depositories shall depute its officials / auditor to monitor the transactions in demat securities of the clients of TM and / or transfer the demat accounts of the clients to another DP.	Within 3 trading days from the date of receipt of information of disablement
4.19	Depositories shall initiate concurrent audit for 100% verification of debit transfers executed from the client accounts and account closures processed by the DP.	Within 7 trading days from the date of receipt of information of disablement
4.20	Depositories shall provide the details of pledges that were invoked by Banks/ NBFCs with whom TM's own securities were pledged in the previous 30 days to the SE / CC.	Within 15 trading days from the date of receipt of information of disablement
Action by ISE /SEs / CCs and Banks		
4.21	Issuance of instruction to the banks that the balance in all the bank accounts of TM / CM shall be frozen for debits by Banks.	Within 1 trading day of receipt of information of disablement
4.22	SEs to direct CCs / CM to invoke the unencumbered collateral deposits including BGs / FDRs	Within 1 trading day from disablement
4.23	CCs / CM shall secure the unencumbered collateral deposits, electronic balances in the depository	Within 1 trading day on receipt of

	accounts of the TM / CM, including BGs as per the directions received from SEs.	information of disablement
	Other actions by ISE/ SEs / CCs	
4.24	With regard to the restoration of securities of clients lying with the CM, post crystallization of balances in the financial ledger of clients by forensic auditor or as per the Auditor's certificate as may be provided by Member: • ISE/ SE / CC shall endeavour to initiate the process to settle debit balance of such client accounts by selling their securities if such clients fail to clear their debit balance after giving notice period for 5 days. • After reconciling the Register of Securities (ROS), the securities of the credit balance clients (fully paid clients) shall be restored to their respective demat accounts. In this regard, the related parties of the trading member shall not be considered for settlement, for which the TM shall provide an undertaking to the SEs / CC.	Within 30 trading days from crystallization of balances
4.25	ISE / SEs / CCs shall endeavour to settle the claims of maximum number of clients by way of interim measures, under their supervision prior to issuing show cause notice (SCN) for declaring the TM a defaulter. The TM shall be instructed to pay small investors out of available funds and own resources (movable and immovable) under the supervision of the ISE / SEs. Further, the unencumbered deposits available with the SEs / CCs, after adjusting for any dues of the SE / CC and maintaining the minimum BMC, shall also be utilised for settling the credit balance of investors starting from the smallest amount. Also any surplus available with any SEs / CCs, shall be utilised for settling the credit balances of clients with respect to other SEs. BGs of the TM shall be invoked and also the FDRs shall be encashed for utilisation. SEs / CC may settle such clients in tranches. For this purpose, the balances of client will be netted across exchanges to arrive at the final credit balance due to such client. The TM shall furnish the proof of payment to the clients, to the SEs.	Within 30 trading days from crystallization of balances

	In this regard, the related parties of the TM shall not be considered for settlement, for which the TM shall provide an undertaking to the SEs / CC. TM to provide indemnity to the SEs to make available the funds to meet any shortfall in meeting investor's claim (other than those who have withdrawn their claim). Clients withdrawing their claim will have to submit unconditional withdrawal letter to the SEs.	
4.26	Issuance of SCN for declaration of TM as a defaulter and the list of members to whom the notice is issued shall be placed on the website of the SE and on such other place, as the relevant authority may deem fit.	After finalization of assets and liabilities as per forensic audit or audit by SEs
4.27	SEs shall intimate the clients about the issuance of the notice / SCN to declare the TM as defaulter including through email / SMS.	Within 3 trading days of the issuance of SCN

5. The above action shall equally apply to a likely event of default by a CM who is also a TM. However, in case of likely default of a Professional CM, the action to be initiated by the CM shall fall upon the CC.

6. As soon as TM is disabled that information shall be shared by ISE with all SEs / CCs. On receipt of such information respective SE shall also conduct their due diligence and may initiate action of disablement by issuing reasoned order by MD of SE concern. However, when SCN has been issued for declaring a TM / CM as a defaulter by any SE, its subsidiary / associate companies which are also member(s) on other segment / SE / CC shall also be put in suspension mode. All their open positions shall be squared off and their assets shall be frozen.

7. Once the Member is disabled or SCN is issued for declaration of defaulter to TM / CM (whichever is earlier), no further Investor Grievance Redressal Committee (IGRC) / Arbitration meetings shall be conducted.

8. Default proceedings shall take place as per bye laws / rules / regulations of the SE / CC. If the member is also a DP, Depositories shall take action as per its bye laws for termination / transfer of its participant-ship based on record. SEs shall not expel the TM immediately until the default proceedings are completed.

9. The TM shall provide a list of all its bank accounts to the SEs /CCs and the SEs / CCs shall obtain an undertaking from the TM within 90 days from the date of issuance of this Circular, undertaking that the SEs / CCs shall be empowered to instruct the bank(s) of the TM to freeze the bank account(s) for debits. The draft of undertaking is enclosed at **Annexure A**.

10. The above SoP enumerates the minimum action which shall be initiated by the respective SEs / CCs / Depositories in accordance with law with effect from August 01, 2020. However, the respective SEs / CCs / Depositories are free to initiate any other actions as may be necessary in compliance with their bye laws / rules / regulations and / or to protect the interest of investors. The ISE / SEs/ CCs and

Depositories are expected to follow the timelines with respect to each actions as enumerated, reasons shall be recorded in case of for any deviation in timelines prescribed.

11. Stock Exchanges, Clearing Corporations and Depositories are directed to:

    a) bring the provisions of this circular to the notice of their members and participants, as the case may be, and also disseminate the same on their websites;
    b) make necessary amendments to their bye-laws, rules, regulations as may be necessary;
    c) communicate to SEBI, the status of the implementation of the provisions of this circular in their monthly development report.

12. This circular is being issued in exercise of the powers conferred under Section 11 (1) of the Securities and Exchange Board of India Act, 1992 read with Section 10 of the Securities Contracts (Regulation) Act, 1956 and Section 19 of the Depositories Act to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

Yours faithfully,

Rachna Anand
General Manager
Market Intermediaries Regulation and Supervision Department

Encl: Annexure A

Annexure A

To be on Stamp / Franked Paper of appropriate value and notarized

AFFIDAVIT OF UNDERTAKING CUM INDEMNITY BOND TO BE SUBMITTED BY MEMBER TO ..... [NAME OF THE STOCK EXCHANGE / CLEARING CORPORATION]

This Undertaking cum Indemnity Bond is signed at Mumbai on this _____day of _____, 20.

By

I/We, **Member of ..... [Name of The Stock Exchange / Clearing Corporation]** (bearing Trading / Clearing No. _____), having office at ....., (hereinafter referred to as "**Member**", which expression, unless repugnant to the context or meaning thereof, shall be deemed to include its successors and assigns).

In favour of:

.....Ltd., [Name of the Stock Exchange / Clearing Corporation] a company incorporated under the Companies Act, 1956 having its registered office at ..... (hereinafter referred to as "**.....**", which expression shall, unless repugnant to the context or meaning thereof, be deemed to include its successors and assigns).

I/We hereby solemnly declare and undertake that:

Whereas the Securities and Exchange Board of India (hereinafter referred to as "**SEBI**") has issued circular dated February ___, 2020 *(date of circular to be inserted)* on Standard Operating Procedure to be followed in the case of trading member/clearing member leading to default (hereinafter referred to as the "said circular").

Whereas in terms of the said circular the …….. [Name of the Stock Exchange / Clearing Corporation] has amended its bye-laws and is empowered …….. [Name of the Stock Exchange / Clearing Corporation] to issue instructions to the concerned bank/s to freeze the bank account/s maintained by the Member, for all debits / withdrawal by the Member in the event of a potential default by the Member in meeting its obligations to Stock Exchange / Clearing Member / Clearing Corporation and / or repayment of funds / securities to his / its clients.

Now, in consideration of the above, I / We do hereby agree and confirm unconditionally to undertake that:

1) …… [Name of the Stock Exchange / Clearing Corporation] is empowered to instruct the concerned banks to freeze my / our bank accounts for all debits / withdrawals from such accounts. The details of bank accounts held by me/ us are as follows:

2) Any debits to such bank account, post freezing by the banks, shall be done only on the express instructions to the said banks by …… [Name of the Stock Exchange/ Clearing Corporation].

3) …… [Name of the Stock Exchange / Clearing Corporation] shall not be liable in any way to me/us for any losses, claims, penalties, proceedings / actions, damages, consequential or otherwise, arising there from or occasioned thereby.

4) No proceeding/suit/action/claims would be adopted by me/us against …… [Name of the Stock Exchange/ Clearing Corporation] for any act done with respect to issuance of instruction to the bank/s mentioned above for freezing of my/our account/s held with the bank/s.

5) I / We agree to indemnify and keep …… [Name of the Stock Exchange/ Clearing Corporation] and/or its successors/assigns indemnified from time to time, and at all times hereafter, against all claims, demands, damages, liabilities, proceedings, losses, actions, charges and expenses made or suffered or incurred or caused or likely to suffer / incur directly or indirectly, to …… [Name of the Stock Exchange/ Clearing Corporation] and/or its successors/assigns on account of freezing of my/our account/s held with bank/s.

6) I/ We shall keep the Bank appropriately notified of the obligations undertaken by me / us herein and authorizing them to honour the instructions from …… [Name of the Stock Exchange / Clearing Corporation].

7) I / We undertake that a revised Undertaking cum Indemnity Bond shall be submitted by me / us to …… [Name of the Stock Exchange / Clearing Corporation] within seven working days of opening of any new bank account or change in details of any existing bank account,

8) This Undertaking cum Indemnity Bond shall be binding on my / our successors, legal representatives and assigns.

9) I / We warrant that representations made by the undersigned / on behalf of the Member are true and correct.

IN WITNESS WHEREOF, I/We hereby execute this Undertaking cum Indemnity Bond on the day, month and year above written.

Solemnly declared at)
this ___ day of _____, 20) BEFORE ME

(Name of Designated Director)
(Name of Trading Member)
(with rubber stamp & SEBI Registration No.)
In the presence of:

1.

2.

Note: Board Resolution for execution of the said undertaking cum indemnity and authorization for signing the same should be enclosed alongwith the document.