

POLICY ON RISK MANAGEMENT SYSTEM

INTRODUCTION:

Harish Kumar Singhania & Co is Securities and Exchange Board of India (SEBI) registered Stock broker of the National Stock Exchange of India Ltd. (NSEIL), BSE LTD

BACKGROUND:

Far reaching reforms have been undertaken by Securities & Exchange Board of India (SEBI) to promote stock market and protect investor interests. Major initiatives taken are in the areas of structure and functioning of stock exchanges, automation of trading and post trade systems and the introduction of surveillance and monitoring systems. Computerized online trading of securities, and setting up of clearing houses / settlement guarantee funds have paved way to expansion of trading locations even at far flung places and bringing about the desired level of transparency and promptness in trading and settlement of dues between the traders and the counterparties.

SEBI is the primary body responsible for regulation of the securities market, deriving its power of registration and enforcement primarily from the SEBI Act. SEBI's functions include:

- Regulating the business in stock exchanges.
- Registering and regulating the working of collective investment schemes, including mutual funds,
- Prohibiting fraudulent and unfair trade practices relating of securities market
- Prohibiting insider trading in securities, with the imposition of monetary penalties, on erring market intermediaries
- Regulating substantial acquisition of shares and takeover of companies
- Calling for information from, carrying out inspection, conducting enquiries and audits of stock exchanges.

SEBI has issued comprehensive guidelines governing issue of shares and other financial instruments, and has laid down detailed norms for Stock Exchanges, Stock Brokers and other intermediaries in the secondary market.

As Share Broking firm, HKS has to consider the risk management issues on two fronts viz. meeting the requirements of the Regulators / Stock Exchanges on risk containment issues and setting its own operational guidelines with proper parameters to combat various risk related issues like regulatory risks, market risks, client risks, employee risks etc. In the following pages we discuss the above issues in two parts, viz. (i) risks containment measures as set in by the regulators/stock exchanges and (ii) our own risk containment measures.

PART A: TAKING CARE OF RISK MANAGEMENT ISSUES AS STIPULATED BY REGULATORS AND EXCHANGES:

SEBI has taken several measures to improve the integrity of the secondary market. Legislative and regulatory changes have facilitated the corporatization of stock brokers. Stock brokers are now subjected to capital adequacy norms. With the advent of screen based trading discarding the age old open outcry trading system through the establishment of National Stock Exchange of India Ltd. (NSE) in 1994, the regulatory responsibilities have largely shifted to the stock exchanges. The stock exchanges are the primary regulators for detection of market manipulation, price rigging and other

regulatory breaches regarding capital market functioning. The stock exchanges in turn are subjected to surveillance and inspection by SEBI.

SEBI exercises its regulatory role on the share broking firms primarily through Stock Exchanges who act as first level regulators. Stock Exchanges conduct inspection of the member stock brokers in the Capital Market segment as well as Derivative Market segment as per regulatory requirements every year. In turn, we are also regularly inspected by SEBI/Exchanges/Depository with whom we are registered as Member/Depository Participant. During such inspections the inspection teams verify the compliance of the provisions of applicable act, rules, regulations, bye-laws, guidelines and circulars by trading and clearing members. The Exchanges initiate necessary disciplinary action against the members in respect of the violation observed during the course of inspection.

In order to protect our image and reputation and at the same time to check any onslaught on our revenue stream, our risk management measures have to essentially remain alive on the compliance to the regulatory issues on the one hand and contain the client risks accentuated by the volatility / uncertainties thrown up by the stock markets, on the other hand.

As the most important risk management tool to have effective control on defaults by clearing members/ trading members the Stock Exchanges have introduced margin and exposure limit concept. In addition a mark-to-market and trading limit have been imposed. In order to contain excess volatility exchanges have put in place circuit breakers. Stock brokers are now required to disclose at the end of the day extent of short sales and long purchases to reduce price volatility and further enhance the integrity of the secondary market.

MARK TO MARKET MARGIN AND INTRA-DAY LIMIT

For retail investors, it is not necessary to take or deliver the shares if equal number of same stock are purchased and sold or vice-versa, during the same settlement period. Thus, squaring-off of the trading position during the same settlement period results in non-delivery of shares that the investor traded. This gives rise to opportunity and temptation to make a short-term and speculative investment at a relative low cost. To contain the risk of settlement chaos that may be caused by an increasing number of non-delivery transactions, SEBI has introduced a daily mark-to-market margin and trading limit. The daily mark-to-market margin is a margin on broker's daily position. The intra-day trading limit is the limit to the broker's trading volume. Every broker is subjected to these requirements.

Each broker's trading volume during a day is not allowed to exceed the intraday trading limit. The limit is 33.3 times the base minimum capital deposited with the exchange on a gross basis, i.e. purchase plus sale. In the event of brokers wishing to exceed this limit, they have to deposit additional capital with the exchange and this cannot be withdrawn for 6 months.

The primary focus of risk management by SEBI has been to address the market risks, operational risks and systematic risks. To this effect SEBI has been continuously reviewing its policies and drafting risk management policies to mitigate these risks, thereby enhancing the level of investor protection and catalyzing market development. The key risk management measures initiated by SEBI include:

- Categorization of securities into groups 1, 2 and 3 for imposition of margins based on their liquidity and volatility.
- VaR based margin system.
- Specification of Mark to Markets margins.

- Specification of intraday trading limit and gross exposure limits.
- Real time monitoring of the intra-day trading limits and Gross Exposure Limits by the Stock Exchanges.
- Specification of time limits of payment of margin.
- Collection of margins on T+1 basis (since modified).
- Index based market wide circuit breakers.
- Automatic de-activation of trading terminal in case of breach of exposure limits.
- VaR based margining system has been put in place based on the categorization of stocks based on the liquidity of stocks depending on its impact cost and volatility. It addresses 99% of the risks in the market.
- Additional margins have also been specified to address the balance 1% case.

An analysis of the above issues is detailed in the subsequent paragraphs in this note.

From February 2005 SEBI modified the above mentioned risk management framework by putting stress on upfront collection of VaR margin (instead of margin collection on T+1 basis). In the revised framework the liquid assets deposited by the broker with the exchange should be sufficient to cover upfront VaR margin, Extreme Loss Margin, Mark to Market margin and the prescribed Base Minimum Capital. The Mark to Market margin would be payable before the start of the next day's trading. The Margin would be computed based on 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 the proprietary position. The exchanges will monitor the position of the broker's online real time basis and there would be automatic deactivation of terminal on any shortfall of margin.

Notes on various Margins / Base Minimum Funds:

VaR Margin – The VaR Margin is a margin intended to cover the largest loss that can be encountered on 99% of the days (99% Value at Risk). For liquid stocks, the margin covers one-day losses while for illiquid stocks; it covers three-day losses so as to allow the clearing corporation to liquidate the position over three days. For liquid stocks, the VaR margins are based only on the volatility of the stock while for other stocks, the volatility of the market index is also used in the computation.

The VaR margin is collected by the exchange 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.

Extreme Loss Margin – It covers the expected loss in situations that go beyond those envisaged in the 99% value at risk estimates used in the VaR Margin.

The Extreme Loss Margin is collected / adjusted against the total liquid assets of the member on a real time basis. The margin so collected is released along with the pay-in.

Shortfall of Margins / Pay-in of funds

a. Margin shortfall

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

b. 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 (BMS) prescribed, 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 and bank guarantee.
- iv) The exchange may levy a penal interest of not less than 0.07% per day on the pay-in shortage of the member.

Additional Margin

The Exchanges /Clearing Corporations have the right to impose additional risk containment measures over and above the risk containment system mandated by SEBI. 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. 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.

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 set off 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 of the member. As regards collection of margin from the broker, the MTM would be grossed across all the clients i.e. no set off 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	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.2000.00.

It would be observed from the above, as of now the issue of meeting margin requirement as stipulated by SEBI assumes the most vital and crucially important factor as even a nominal shortfall in margin would automatically lead to deactivation of the broker's trading terminals throughout the country. Such an event would be disastrous for the broker and would dent a heavy blow to its reputation within the broking community. Any broking firm thus can hardly afford to neglect its liquidity.

PART B: TAKING CARE OF RISKS AS PERCEIVED BY HKS

Risk Management Measures of HKS in Cash Segment:

It is, therefore, clear that all branches must have systems and procedures to ensure the above concerns of SEBI. In HKS we have taken care of the above concerns as under.

- i) Trading is allowed only against available margin in client's account. For this purpose, margin should be actually available at the time of entering trade in the cash segment of NSE / BSE either in the form of credit balance in the trading account and/or securities by way of Pledge in Client Securities Pledge account.
- ii) Shares held in Pledge account (shares on hold pending receipt of cheques from clients) are subjected to suitable hair-cuts and such hair-cuts are reviewed from time to time depending on the market condition. In a turbulent and chaotic market condition hair-cuts are appropriately raised and in stable market conditions comparatively low hair-cut percentages are maintained.
- iii) We are giving exposure limit (buying & selling) at 8 times of effective margin to the client during the day. Within the exposure limit, a client can do intra-day trading a number of times, the aggregate volume being controlled by an overall turnover limit. For example, if client margin is Rs.5000.00 and Gross Exposure limit is Rs.40000.00, a client may be allowed to do aggregate intra-day 50 times of his margin i.e. Rs.250000.00 but at any point of time during the day total exposure would not exceed his Gross Exposure limit of Rs.40000.00.
- iv) Effective margin is computed as under:
Client Ledger (Cheque updated up to 5 p.m. of the previous day) + securities given as margin deposit with appropriate (20-25%) haircut + hold back securities kept in trust account with appropriate (30-35%) hair cut – 0.15 % of open Purchase – 0.15% of open Sales.

An illustration on computation of effective margin is furnished below.

Computation of effective margin:

Suppose a client has deposited Rs.10000/- cash and securities margin amounting to Rs.20000/-. He has a ledger balance of Rs.1000.00 Cr.

He has done the following transactions:

Date	Settlement No.	Buy (Rs.)	Sale (rs.)	Total obligation	Net obligation
T	1	20000	10000	30000	(-)10000

T+1	2	25000	2000	45000	(-) 5000
Total		45000	3000	75000	(-)15000

Margin Computation

Particulars	Hair cut	Amount	Amount in Rs.
Cash Margin	0%	A	10000
Share Margin	15%	B	17000*
Total Margin		A+B	37000
Effective Ledger Balance (E)			
Ledger balance	L		1000
Open settlement 1	Sett-1		(-)10000
Open Settlement 2	Sett- 2		(-) 5000
Net Obligation	L+Sett-1+Sett-2		(-)14000
Add purchase of open sett		P	45000
Total		O+P	31000
Less: Sale of open sett.		S	30000
Less: 10% of Purchase of open sett.		0.10P	4500
Less: 15% of Sale of open sett.		0.15P	4500
Net Balance (E)		(O+P-s)-0.10P-0.15S	(-)8000
Net Margin on which exposure will be given		(A+B+E)	29000

* after 15% hair-cut

Margin exemption on early pay-in of securities:

In cases where early pay-in of securities is made up to 3 p.m. on a day, such positions for which early pay-in of securities is made shall be exempt from margins. The margin file upload is done at the following intervals 11 a.m., 2 p.m. and 3 p.m. The benefits of early pay-in done after 3 p.m. on a day will be available on the next trading day. The branch should execute early pay-in instructions before that time limit.

v) Buying exposure is not allowed without being backed by adequate margin but selling is allowed to any extent if the client wishes to sell from his holdings in Demat account. Branches are required to ask for selling exposure only in those cases where client ledger account shows debit balance which is more than the balance of share margin after hair cut as in such cases in the morning in the Exposure Limit screen zero margin is uploaded for which branches have to specifically ask for sell limit.

vi)Maximum exposure of a particular client is Rs.10 lacs at a time subject to fulfilling margin requirement as stated above.

vii)Risk Management Section performs a real time monitoring on the intra-day position of the client through NEATXS screen.

viii)A client's position across all segments and stock exchanges is considered by Risk Management Section while controlling the exposure of the client.

ix) If deals are not squared off same day by the client, branches have to collect cheque from the concerned clients covering the relative debit raised in the client account (purchase price + brokerage + security transaction tax) on T+1 day. If cheque is not forthcoming, Branch Manager should pursue with the client for payment through cheque as early as possible. In any case, if debit is not adjusted by client either by paying through cheque or by sale of securities, branches have to square off the debit on T+3rd day.

RMS Policy Change: (Forming Part and Parcel of the Existing RMS Policy) effective 01.10.2019

As Prescribed in the SEBI Circular dated 20th June 2019 the following changes have been incorporated in the existing Policy in line with the SEBI Circular approved by the Board of directors:-

In order to meet the requirements of the said Circular following Policy has been adopted w.e.f 01st October 2019.

- 1) The clients have been categorised in two categories: Category A and category B

Category A Clients: The clients falling under this category are those clients who are well known and have been referred through one or more references who are directly/indirectly known to the Key managerial Person of the company. Further they are those clients who have a sound payment track record without any controversy.

Category B Clients: The clients falling under this category are those clients who are walk in clients/sourced clients and have not been referred through one or more references and who are either directly/indirectly not known to the Key managerial Person of the company.

Policy/Procedure for the respective category.

- 2) **Category A Clients:** shares Purchased by these clients will be transferred to their respective demat account on the 5th trading day from the pay-out even when there is a debit balance in the ledger and an Interest will be charged to their debit balance @ 24% P.a till the Payments are cleared. No further exposure will be provided to such clients if there Ledger is in debit till the funds are cleared. Funds received by EFT mode and credited to our bank account and the ledger of the clients is into credit only then the further exposure will be granted. No exposure will be granted on the basis of an account payee cheque Provided/deposited by the clients till the funds are realised and credited to our account.
- 3) **Category B Clients:** shares Purchased by these clients will not be transferred to their demat account and instead shall be kept in a separate account specified by the above mentioned circular " Client Unpaid securities account" till the 5th trading day from the pay out if the ledger of the client is in debit. If the Clear Funds are not received from these clients within 5th Trading day from the pay-out then such securities kept in the CUSA account shall be disposed off in the market on the 5th trading day from the pay-out /or earlier if it seems reasonable and the relevant Profit/Loss shall be accordingly posted in the client Ledger. Interest @ 24% shall be charged to their ledger balances since the beginning of the debit balance till the clear funds are received either by way of disposing off the securities in the market/ and or funds received from these clients. This is equally applicable in case of Physical settlement made under derivative trading.
- 4) **Option for Category A Clients:-**Clients falling under this category and whose shares have been transferred to their demat account and the ledger is in debit then as per the adopted Policy an

option shall be given to such clients to either clear the debit balance by paying an equivalent amount/ or more and shall also be allowed to clear the debit balance by selling an equivalent Qty of shares if they wish to sell off the securities kept in "Client collateral account" and or shares in "Collateral account" which has been transferred to CM/CC to adjust the debit balance. However an Interest on the debit balance @ 24% will be applicable as prescribed above till the funds are not cleared.

- 5) **Option for Category B Clients:-**Clients falling under this category shall be given an Option to sell the securities lying in the "Client collateral account" and or shares in "Collateral account" which has been transferred to CC/CM to adjust the debit balance within 5th Trading days from the Pay out without diluting the shares kept in the CUSA account. Once the Client Ledger is in credit either by paying an equivalent amount of debit balance or more within 5th trading day from the pay out or by selling the securities in Client collateral account" and or shares in "Collateral account" which has been transferred to CC/CM, then the shares in CUSA account shall be transferred to the demat account of the respective client within 24 hours.

Further in case of Partial payment by these clients and still the ledger is in debit the shares/securities in CUSA account will be sold in proportion of the debit balance after considering any credit available in the ledger. The balance shares if any shall be transferred to the clients demat account on the 5th Trading day from the Pay-out. In case Client Specifically request for transfer of Shares/Securities on or before the 5th Trading day from the pay out where the amount is paid then such securities shall be transferred to the clients demat account and only the balance will be sold to recover the debit balance. Profit/loss arising out of such transaction shall be accordingly debited/credited in the Clients Ledger.

General Provisions:-

- 6) No Pre order Confirmation will be taken from clients when the Shares/Securities are sold from CUSA account to realise the debit balance, however necessary margin calls/debit balance will be intimated/informed to ensure that the client is aware of the scenario under which such shares/securities have been disposed off in the market within 5th Trading day of from the pay-out.
- 7) If any Shares/Securities are unable to be sold in the market within 5th trading day from the pay-out due to reasons such as Lower Circuit/Court/regulatory order/GSM and or such shares/Securities have been freezed then the shares will be kept in CUSA account till the time such shares/Securities have been enabled to be sold off in the market and any charges levied by the relevant depository on the same will be required to be reversed by making an application to the relevant depository after citing the necessary reasons for the same. The Charges levied by Depository shall not be recovered from the client however the Interest @24% will continue to be applicable till the ledger is in debit.
- 8) Shares/securities kept in CUSA account shall be considered towards meeting the margin obligation of the exchange after adjusting the debit balance. Only Free/Unencumbered balance available thereafter shall be considered while reporting to exchange on the margin requirement of the respective client. The Balances if any (credit balance) lying in the Client ledger w.r.t MTF Facility shall not be adjusted while considering the margin reporting requirement of CUSA account shares. Shares/Securities Purchased under MTF facility will not be eligible to be used as margin for that client in any other segment as the same are not free.

- 9) Running account authorisation provided by the client shall be ensured for settlement of funds as consented by the client within 30/90 days after retaining the amount required to meet the margin obligation and in compliance of the Circular **NSE circular NSE/INSP/36889 dated 02-Feb-2018**. Further all the shares/Securities lying in the "Client Collateral account" and or Collateral account shall also be required to settle once in 30/90 days after retaining the amount required to meet the margin obligation and in compliance of the Circular **NSE circular NSE/INSP/36889 dated 02-Feb-2018**.
- 10) Shares/Securities Lying in the CUSA account and as per the Policy if the same is required to be disposed off then client will be given an option to either inform us about the shares/securities that can be sold from the "Client Collateral account" or "Collateral account" if any shares are available in these accounts. In the absence of any information from the client the shares shall be disposed following FIFO (First in First out) method. No Pre order confirmation will be required for selling the same.
- 11) Clients trading in the derivative segment of the exchange shall now be required to transfer the shares/securities to the new Demat account named/tagged as "Client Collateral account". Accordingly clients who have executed a POA in favour of "Nakamichi Securities Limited" then such required qty of shares/securities to either meet the margin obligation/Pay in obligation shall be transferred to "Client Collateral account" and or Pool Account accordingly. Further if required the shares/Securities lying with us in Client Collateral Account be transferred to Clearing corporation/Clearing member then such shares of the required qty shall be transferred to Collateral account client wise and will be onward transferred to CC/CM. In no case shares/securities of one client be used for providing exposure to other clients/own trades. Vice versa Process will be followed for receiving back the securities/Shares transferred to CM/CC. whenever required by the client and upon specific request for transfer of Securities/Shares to the demat account of the client the same shall be undertaken within 24 hrs of the request made by the Client. Settlement of the Running accounts for Funds/Securities will be governed by NSE circular **NSE/INSP/36889 dated 02-Feb-2018**.
- 12) The clients whose Ledger is in debit and upon reaching the 5th Trading day from the date of Pay Out when the shares in CUSA will be required to be disposed off/ or as per our Policy of Liquidating the Scrips if the same is being liquidated from Client Collateral account/Collateral account then the BUY in the same scrip will not be allowed on the selling day. Further as required by the SEBI Circular **SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated 26-Sep-2016** shall be diligently followed for providing the further exposure if the ledger is in debit till the clear funds are received.
- 13) In case of any client who has traded in the Securities where Inter depository facility is not available then a request will be made to client to open a demat account with the respective depository and in case the client does not wish to open a new account then such shares/securities will be transferred to "Client collateral account". The same will be considered towards meeting the margin obligation requirement of the respective client. Securities/shares under this category will not be eligible to be settled as per running account authorisation. Same will be kept in "Client collateral account" till the time such shares/securities are sold by the client in the market.
- 14) No Direct pay out facility shall be offered to any of the clients even when the Ledger is in credit.

For M/s H K Singhania & Co