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SEBI/MIRSD/Master Cir-04/2010
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The Executive Directors / Managing Directors / Chief Executive Officers
All Stock Exchanges/Clearing Corporations

Sub: Master Circular on Oversight of Members (Stock Brokers/Trading Members/Clearing Members of any Segment of Stock Exchanges and Clearing Corporations)

1. This master circular consolidates and updates the requirements/obligations with regard to oversight of members (Inspection by Stock Exchanges/Clearing Corporations, Internal Audit and Default) prescribed by the following circulars:
 - A. Circular no. SMD(B)/104/22775/93 dated October 29, 1993
 - B. Circular no. SMD/MDP/CIR/043/96 dated August 5, 1996
 - C. Circular no. SMD/Policy/Cir-24/97 dated September 26, 1997
 - D. Circular no. SMDRP/POLICY/Cir-45/2001 dated September 17, 2001
 - E. Circular no. SEBI/SMD/DBA-1/CIR-27/2003 dated June 25, 2003
 - F. Circular no. MIRSD/DPSIII/Cir-26/08 dated August 22, 2008, and
 - G. Circular no. MRD/DMS/Cir-29/2008 dated October 21, 2008

I. Inspection of Members by Stock Exchanges / Clearing Corporations

2. The Stock Exchange or the Clearing Corporation, as the case may be, shall, in consultation with SEBI, formulate a policy for inspection of members and follow up action thereon.
3. The Stock Exchange or the Clearing Corporation, as the case may be, shall inspect all active members in various segments every year.
4. The inspection shall cover:
 - a. Compliance with the relevant provisions of the Act, Rules and Regulations made there under, Rules and Regulation of the Stock Exchange / Clearing Corporation and the circulars issued by SEBI and Stock Exchanges / Clearing Corporations from time to time, and
 - b. Efficacy of the investor grievance redressal mechanism and discharge of various obligations towards clients,
for the preceding one year unless a longer period is warranted in the circumstances.
5. An illustrative list of common violations/deficiencies observed by SEBI in its inspections of members is enclosed as Annexure. The Stock Exchanges and Clearing Corporations are advised to bring this list to the notice of members with an advice to them to avoid these violations/deficiencies.
6. The Stock Exchange or the Clearing Corporation, as the case may be, shall initiate all the follow up action – remedial, penal and disciplinary - required on inspection findings, within 6 months from the conclusion of the inspection.

II. Internal Audit

7. The member shall carry out complete internal audit on a half yearly basis by an independent qualified Chartered Accountant, Company Secretary or Cost and Management Accountant who is in practice and does not have any conflict of interest.
8. The audit shall cover, inter alia,
 - a. the existence, scope and efficiency of the internal control system,
 - b. compliance with the provisions of the SEBI Act, 1992, Securities Contracts (Regulation) Act 1956, SEBI (Intermediaries) Regulations, 2008, SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992, circulars issued by SEBI from time to time, Bye Laws and Regulations and circulars issued by the Stock Exchange / Clearing Corporation,
 - c. data security and insurance in respect of operations, and
 - d. efficacy of the investor grievance redressal mechanism and discharge of various obligations towards clients.
9. The internal auditor shall submit the audit report to the member, who shall place it before its Board of Directors/Proprietor/Partners and shall forward the same along with para-wise comments to the respective stock exchange/clearing corporation within three months from the end of the half year period.
10. The Stock Exchange/Clearing Corporation shall analyze the audit reports so received and take appropriate follow up action.
11. The Stock Exchange/Clearing Corporation shall initiate appropriate actions – remedial, penal or disciplinary - against the members where deficiencies are noticed in audit reports or where audit report has not been received, and inform the details of action taken to SEBI, within six months from the end of the half year period.

III. Default in case of Multiple Membership

12. Whenever a member of any segment is declared defaulter, the concerned Stock Exchange/Clearing Corporation shall immediately declare it a defaulter in all its segments. It shall also immediately inform all other Stock Exchanges/Clearing Corporations the details of the defaulter member such as name of the member, the names of the proprietors/partners/promoters/dominant shareholders, as applicable.
13. Immediately on receipt of the information about default of a member, the Stock Exchange / Clearing Corporation shall declare the said member defaulter on all its segments.
14. The Stock Exchanges / Clearing Corporations shall take appropriate action against the associates of defaulter member. For this purpose, the term 'associate' shall include a person:
 - a. who, directly or indirectly, by itself, or in combination with other persons, exercises control over the member, whether individual, body corporate or firm or holds substantial share of not less than 15% in the capital of such entities; or
 - b. in respect of whom the member, individual or body corporate or firm, directly or indirectly, by itself or in combination with other persons, exercises control; or

- c. whose director or partner is also a director or partner of the member, body corporate or the firm, as the case may be.

Explanation: The expression "control" shall have the same meaning as defined under clause (c) of Regulation 2 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

IV. Implementation

15. For the above purpose, the Stock Exchanges / Clearing Corporations shall take all necessary action, including the following:
 - a. make necessary amendments to the relevant bye-laws, rules and regulations for the implementation of the above decision immediately, if the same has not been already made.
 - b. bring the provisions of this circular to the notice of the members and also to disseminate the same on the website, and
 - c. communicate to SEBI, the status of the implementation of the provisions of this circular in the Monthly Development Report.
16. This circular is issued in exercise of the powers conferred by Section 11 (1) of Securities and Exchange Board of India Act, 1992 to protect the interest of investors in securities and to promote the development of, and to regulate, the securities market.
17. The circulars mentioned in Para 1 of this Master Circular stand rescinded. Notwithstanding such rescission, anything done or any action taken under those circulars before the date of this Master circular, shall be deemed to have been done or taken or commenced under the corresponding provisions of this circular. After the rescission of the earlier circulars referred to in para (1), any reference thereto in any regulation, guidelines and circulars shall be deemed to be a reference to this Master Circular.

Yours faithfully,

(B. N. Sahoo)

Annexure

The common irregularities observed in the Stock brokers/trading members books are brought to the notice of all. They are as follows:

S.No	Description
I	<p><u>Relating to KYC</u></p> <ol style="list-style-type: none"> 1. 'In person verification' not done while opening the account. Photo copy of KYC & agreement are not provided to clients; if provided proof of delivery/dispatch is not maintained 2. Adding clauses in broker-client agreement/tripartite agreement which are contrary to the clauses as prescribed in Model agreements. Voluntary clauses in agreements are not highlighted as 'voluntary' and signatures of clients taken on all the documents
II	<p><u>Relating to Contract notes:</u></p> <ol style="list-style-type: none"> 3. Contract notes are not bearing serial numbers, SEBI registration numbers, Order no. & time. Contract notes are not issued in the prescribed format/not issued within 24 hours of trade execution/not signed properly by the broker or his authorised representatives 4. Duplicates/counterfoils/acknowledged copies of the contract notes issued not being maintained or maintained with inadequate details. 5. Not issuing contracts in Form B while acting as principal 6. Appropriate stamp duty not paid and charging Securities Transaction Tax (STT) on non equity funds transactions by the brokers. 7. Brokerage is not shown separately on contract notes. The correct rate at which the transaction was executed is not passed on to the client 8. Charges other than brokerage and statutory charges levied on the clients which are not specifically agreed upon by the clients or charging more than the limits prescribed. 9. In case the Electronic Contract Notes (ECN) are issued, the same are not made available on brokers' websites/ sending ECN on single email-id for a group of clients/not maintaining ECN logs for ECN sent to the clients
III	<p><u>Relating to Investor services</u></p> <ol style="list-style-type: none"> 10. Deficiency in service to the clients 11. Non maintenance of investor grievance register and lack of proper system for receipt and reconciliation of investor grievances/not taking adequate steps for redressal of grievances of investors within one month from the date of receipt of the complaint. 12. Non maintenance of client database or details captured wrongly in the database 13. There are delays between pay-out by the exchange to their members and the transmission of shares/money received in such pay-out to their clients by brokers without any record of reasons for such delay. 14. Non dissemination of email ID created for receiving investor grievances to the investors 15. Freezing of accounts of clients without giving adequate reason 16. Providing multiple client codes to one client/using same PAN no. for more than one client 17. Frequent trade modification/client code modification done in client account 18. Daily margin statement and quarterly statements not sent to clients 19. Relationship managers acting as portfolio managers by entering into verbal agreement with clients for trading on their behalf

IV	<p><u>Relating to funds and securities</u></p> <p>20. Unauthorized trading activities carried out in client's account</p> <p>21. Not having separate account for clients' funds/securities or having separate accounts for clients but not segregating clients' funds/securities from its own funds/securities.</p> <p>22. The brokers are found involved in funding activities - with the exception of those in connection with or incidental to or consequential upon the securities business.</p> <p>23. Non collection of margin from clients/wrong reporting of collection of margins to exchanges/clearing members</p> <p>24. Accepting cash from the clients. Accepting/giving third party payments/receipts</p> <p>25. Pledging client's securities without explicit authorization from client. The details of shares pledged not being informed to client</p>
V	<p><u>Relating to terminals</u></p> <p>26. Not putting the unique client code (UCC) of clients while placing orders in the trading system.</p> <p>27. The broker granting the trading terminals at places other than that specified by SEBI e.g. registered office, branch office or registered sub brokers' offices.</p> <p>29. Terminals operated by personnel without having proper qualification/ persons operating the terminal are not employees/remissers/sub brokers of stock brokers</p>
VI	<p><u>Others</u></p> <p>30. Non-maintenance or improper maintenance of Books of Accounts which are required to be maintained as per Rule 15 of SC (R) Rules, 1957 and Regulation 17 of SEBI (Brokers and Sub-Brokers) Regulations 1992</p> <p>31. Non-compliance with provisions relating to spot/negotiated deals</p> <p>32. Instances of the broker/dealers/others connected with the broker, involved in front running, circular trading, creating false markets, misuse of the exchange mechanism for securing financing transactions, entering fictitious transactions and illegal transactions</p> <p>33. Non submission of audit report/internal audit reports within the prescribed time limit</p> <p>34. Dealing with unregistered sub-brokers/acting through brokers of other exchanges for its clients without registering as a sub broker of these brokers</p> <p>35. Involved in business other than the securities business in violation of applicable laws</p> <p>36. Non payment/ inadequate payment of SEBI registration fees by the stock brokers and also by their sub brokers</p> <p>37. Not taking prior permission from SEBI for change in status and constitution.</p> <p>38. Not complying with the provisions of advertisements/internet based trading</p> <p>39. Non appointment of compliance officer.</p> <p>40. Non- compliance with trading restrictions imposed by Stock Exchanges</p> <p>41. Trading in unlisted securities and in securities prior to their admission to dealings by Exchanges</p> <p>42. Not reporting off-the-floor transactions (e.g.) (a) The transactions with stock brokers of other exchanges (b) Principal to principal transactions with clients (c) Transactions done after the trading hours.</p> <p>43. Not informing the investors/general public about cancellation of registration of its sub broker(s)</p> <p>44. Non-formation of policies related to internal controls, employee/insider trading, Prevention of Money Laundering (PML) etc. If policies are formulated, they are not implemented.</p> <p>45. Delivery vs payment (DvP) trades are done in other than those circumstances as prescribed.</p>