

## **Guidelines on Securities Transactions to be followed by Primary Dealers**

IDMC No.PDRS./2049A/03.64.00/ 99-2000

December 31 , 1999.

All Primary Dealers in the Government securities market

Dear Sirs,

### Guidelines on Securities Transactions to be followed by Primary Dealers

As you are aware, Reserve Bank of India (DBOD for banks and FID for All India Financial Institutions) have been issuing guidelines on various aspects relating to the securities transactions by entities under their jurisdiction (e.g. circular DBOD.FSC.BC.143A/24.48.001/91-92 dated June 20, 1992 for banks and FIC.984-994/01.02.00-91/92 dated June 23, 1992 for All India Financial Institutions). These, amended from time to time, have been made applicable, *mutatis mutandis*, to the subsidiaries and mutual funds established by banks and Financial Institutions except where they are contrary to specific SEBI and RBI regulations governing their operations. Hitherto, the Primary Dealers which are subsidiaries of banks were following the instructions contained in the above issues. Since some of the Primary Dealers do not belong to the category of subsidiary of a bank/Financial Institution, these stipulations are not being applied to the non-subsidiary Primary Dealers. A need for bringing in uniformity in the guidelines applicable to all the Primary Dealers has therefore been felt. The enclosed Annexure contains the guidelines that would be applicable to all the Primary Dealers irrespective of whether they are subsidiaries of banks/Financial Institutions, companies set up by foreign entities etc. These guidelines are primarily intended to set standards for internal organisation and prudential operational conduct and need to be followed notwithstanding the guidelines issued to banks and Financial Institutions on the subject.

2. The guidelines are contained in two parts. The instructions given in Part A would need to be compulsorily adopted/adhered to by the Primary Dealers. Part B contains the prudential checks and balances and systems any market participant is expected to have in place. The Primary Dealers may review their existing systems with regard to these prudential practices and modify their systems suitably wherever required.

3. The Primary Dealers may please confirm to us that they have adopted /put in place internal control guidelines for securities transactions incorporating the enclosed guidelines. A report on the implementation of the guidelines may be furnished to us by February 29, 2000.

Please acknowledge receipt.

Yours faithfully,

(Usha Thorat)  
Chief General Manager  
Encl: As above.

**Attachment**  
**Guidelines on Securities transactions**  
*to be followed by Primary Dealers*

**Part - A**

**Guidelines to be compulsorily adopted/implemented by the PDs**

**1) Management oversight, policy/operational guidelines** - The management of a Primary Dealer should bear primary responsibility for ensuring maintenance of appropriate standards of conduct and adherence to proper procedures by the entity. Primary Dealers should frame and implement suitable policy guidelines on securities transactions. Operational procedures and controls in relation to the day-to-day business operations should also be worked out and put in place to ensure that operations in securities are conducted in accordance with sound and acceptable business practices.

With the approval of respective Boards, the PDs should clearly lay down the broad objectives to be followed while undertaking transactions in securities on their own account and on behalf of clients, clearly define the authority to put through deals, procedure to be followed while putting through deals, various prudential exposure limits, policy regarding dealings with brokers, systems for management of various risks, guidelines for valuation of the portfolio and the reporting systems etc. While laying down such policy guidelines, the PDs should strictly observe Reserve Bank's instructions, if any, on the following:

Ready Forward deals  
Transactions through SGL Account  
Internal Controls/Risk Management System  
Dealings through Brokers  
Accounting Standards  
Audit, Review and Reporting  
Any other instructions issued from time to time

The internal policy guidelines on securities transactions framed by the PD, duly certified by its management to the effect that they are in accordance with the RBI guidelines and that they have been put in place, may be perused by the Statutory Auditors and commented upon as to the conformity of the guidelines with the instructions/guidelines issued by RBI.

The effectiveness of the policy and operational guidelines should be periodically evaluated.

**2) Prohibition of short selling of securities** - The Primary Dealers should not put through any sale transaction without actually holding the security in its portfolio i.e. under no circumstances, a PD should hold a oversold position in any security.

**3) Concurrent audit of securities transactions** - Securities transactions should be separately subjected to a concurrent audit by internal/external auditors to the extent of 100% and the results of the audit should be placed before the CEO/CMD of the PD once every month. The compliance wing should monitor the compliance on ongoing basis, with the laid down policies and prescribed procedures, the applicable legal and regulatory requirements, the deficiencies pointed out in the audits and report directly to the management.

**4) All problem exposures where security of doubtful value, diminution of value to be provided for** - All problem exposures, if any, which are not backed by any security or backed by security of doubtful value should be fully provided for.

**5) Provision also for suits under litigation** - Even in cases where a PD has filed suit against another party for recovery, such exposures should be evaluated and provisions should be made to the satisfaction of auditors.

**6) Claims against the PD to be taken note of and provisions made** - Any claim against the PD should also be taken note of and provisions made to the satisfaction of auditors.

**7) Problem exposures to be reflected clearly in Profit and Loss Account** - The profit and loss account should, reflect the problem exposures, if any, as also the effect of valuation of portfolio, as per the instructions issued by the Reserve Bank, if any, from time to time. The report of the statutory auditors should contain a certification to this effect.

**8) Business through brokers and contract limits for approved brokers** - A disproportionate part of the business should not be transacted through only one or a few brokers. PDs should fix aggregate contract limits for each of the approved brokers. A limit of 5%, of total transactions (both purchase and sales) entered into by a PD during a year should be treated as the aggregate upper contract limit for each of the approved brokers. This limit should cover both the business initiated by a PD and the business offered/brought to the PD by a broker. PDs should ensure that the transactions entered into through individual brokers during a year normally does not exceed this limit. However, if for any reason it became necessary to exceed the aggregate limit for any broker, the specific reasons therefor should be recorded, in writing, by the authority empowered to put through the deals. Further, the board should be informed of this, post facto. However, the norm would not be applicable to PD's dealings through other Primary Dealers.

**a) Business through brokers to be audited** - The concurrent auditors who audit the securities operations should scrutinise the business done through brokers also and include it in their report to the CEO/CMD of the PD. Besides, the business put through any individual broker or brokers in excess of the limit, with the reasons therefor, should be covered in the review to the Board of Directors.

**9) Investments in and Underwriting of Shares, Debentures and PSU Bonds and Investments in Units of Mutual Funds - Guidelines** - PDs should formulate, within the above parameters, their own internal guidelines, as approved by their Board of Directors, on securities transactions either by directly subscribing or through secondary market with counter-party or counter-party group, including norms to ensure that excessive exposure against any single counter-party or group or product is avoided and that due attention is given to the maturity structure and the quality of such transactions. The PDs will also need to take into account the fact that such securities are subject to risk weight and necessary depreciation has to be fully provided for.

**10) Material changes in circumstances** - The PDs should report any material changes in circumstances such as change in the ownership structure, business profile, organisation etc. affecting the conditions of licensing as PD to RBI immediately.

## Part B

### Prudential systems/controls the PDs are expected to have in place

#### 1) Internal Control System in respect of securities transactions

**a) Same day accounting for transactions** – All the transactions put through by the PD either on outright basis or ready forward basis should be reflected on the same day in its books and records i.e. preparation of deal slip, contract note, confirmation with the counter party, recording of the transaction in the purchase/sale registers etc.

**b) Functional separation of trading, settlement, monitoring and control and accounting** - There should be a clear functional separation of (i) trading, (ii) settlement, monitoring and control and (iii) accounting and reconciliation. Similarly, there should be a separation of transactions relating to own account, and Constituents accounts.

**c) Norms for the deal slip** - For every transaction entered into, the trading desk should prepare a deal slip which should contain data relating to nature of the deal, name of the counter-party, whether it is a direct deal or through a broker, and if through a broker, name of the broker, details of security, amount, price, contract date and time and settlement date. The deal slips should be serially numbered and controlled separately to ensure that each deal slip has been properly accounted for. Once the deal is concluded, the dealer should immediately pass on the deal slip to the back office for recording and processing. For each deal there must be a system of issue of confirmation to the counter-party. The timely receipt of requisite written confirmation from the counter-party, which must include all essential details of the contract, should be monitored by the back office.

**d) No substitution of counter party** - Once a deal has been concluded, there should not be any substitution of the counter-party by another by the broker, through whom the deal has been entered into. However, under exceptional circumstances, the counter-party may be required to be substituted. It is advised that such substitution should only be under exceptional circumstances, should be properly documented and brought to the notice of the competent senior management authority to whom approval powers for such substitution is delegated.

**e) No substitution of security** - The security sold/purchased in the deal should not, however, be substituted by another security under any circumstances.

**f) Passing of vouchers, contracts verification** - On the basis of vouchers passed by the back office (which should be done after verification of actual contract notes received from the broker/counter-party and confirmation of the deal by the counter party), the Accounts wing should independently write the books of account.

**g) Reconciliation of balances** - Balances as per PDs books should be reconciled at quarterly intervals with the balances in the books of PDOs. If the number of transactions so warrant, the reconciliation should be undertaken more frequent intervals. This reconciliation should be periodically checked during audit.

**h) Valuation of portfolio** - The PDs should have an independent set up for valuation of the portfolio. The valuation of the securities portfolio should be independent of the dealing and

operations functions and should value the portfolio by obtaining the rates etc. from market sources.

**i) Reporting system for PDs on deals, bouncing of SGL Transfer Forms** - PDs should put in place a reporting system to report to the top management, at periodical intervals, the details of transactions in securities, details of bouncing of SGL transfer forms issued by other counter-parties and BRs outstanding for more than 15 days and a review of securities transactions undertaken during the period.

### **2) Norms for ready – forward deals in Treasury Bills and other Government Securities**

**a)** The purchase/sale price of Treasury Bills and other specified Government securities should be in alignment with the proximate market rates prevalent on the date of the original transaction for the relevant securities.

**b)** The securities should not be sold by the PDs unless the same are held by them in their own account in the manner as stated at Item no. 2) of Part A and the transactions are effected in Mumbai and the deals are put through SGL Account with the Reserve Bank at Mumbai.

**c)** Immediately on sale, the corresponding amount should invariably be deducted from the account of PD and its assets for the entire period of holding by the purchaser/counter-party.

**d)** Securities bought under reverse repo can not be traded/sold/further repoed before the reversal date. Such securities should be kept separate, the modus operandi and nomenclature of which may be decided on by the individual PDs.

### **3) Purchase/ Sale of securities through Subsidiary General Ledger Account**

**a) Bouncing of SGL Transfer Forms** – Under no circumstances, a SGL transfer form issued by a PD in favour of another counter-party should bounce for want of sufficient balance in the SGL Account.

**b) Immediate depositing of SGL Transfer Forms** – SGL Transfer forms received by purchasing PDs should be deposited in their SGL Accounts immediately i.e. within a period of one working day from the date of signing of the transfer form by the seller. No sale should be effected by way of return of SGL form held by the PD.

**c) SGL Transfer form to be signed** - SGL Transfer forms should be signed by two authorised officials of the PD whose signatures should be recorded with the respective PDOs of the Reserve Bank and other counter-parties.

**d) SGL Transfer Form in standard format** – The SGL transfer form should be in standard format prescribed by the Reserve Bank and printed on semi-security paper of uniform size. They should be serially numbered and there should be a control system in place to account for each SGL form.

**e) Record of SGL forms** - Records of SGL transfer forms issued/received, should be maintained.

**f) Authenticity of SGL forms** - A system for verification of the authenticity of the SGL transfer forms received from the counter-party and confirmation of authorised signatories should be put in place.

**g) Bouncing of SGL Form** - Any instance of return of SGL form from the Public Debt Office of the Reserve Bank for want of sufficient balance in the account should be immediately brought to the notice of the PD's top management and reported to Reserve Bank with the details of transactions.

#### **4) Use of Bank Receipt or Similar Receipt**

**a) Bank Receipt** - Bank Receipt or similar receipt should not be issued by the PDs under any circumstances in respect of transactions in Government securities for which SGL facility is available.

**b) Acceptance of BR only when** - PDs may accept BR in respect of securities where SGL facility is not available only under the following circumstances :

- i) The scrips are yet to be issued by the issuer and the seller is holding allotment advice.
- ii) The security is physically held at a different centre and the seller is in a position to physically transfer the security and give delivery thereof within a short period.
- iii) The security has been lodged for transfer/interest payment and the seller is holding necessary records of such lodgement and will be in a position to give physical delivery within a short period.

**c) Authenticity of BRs** - A system for verification of the authenticity of the BRs received from the counter-party and confirmation of authorised signatories should be put in place.

**d) No issue of BR with another BR** - No BR or similar receipt should be issued on the basis of a BR held by the PD and no transaction should take place on the basis of mere exchange of BRs held by the PD.

**e) BR not to remain outstanding** - No BR should remain outstanding for more than 15 days.

**f) BR to be redeemed only by actual delivery of scrips** - A BR should be redeemed only by actual delivery of scrips and not by cancellation of the transaction/setting off against another transaction.

**g) Maintenance of BR Records** - Separate register of BRs received should be maintained and arrangements should be put in place to ensure that these are systematically followed up and liquidated within the stipulated time limit.

**h) Allotment Advice** - Primary Dealers may receive Allotment Advices in respect of securities subscribed to/purchased, in case the issuing institution is not able to issue the scrip immediately. For onward trading of such Advices, the PDs should ensure the tradability of the Advices in consultation with their legal counsel before undertaking trading transactions. The Advices should also be subjected to verification of authenticity, safe custody and keeping proper record/account etc. safe guards.

## **5) Retailing of Government securities**

**a) Retailing to be on the basis of ongoing market rates** - The retailing of Government securities should be on the basis of ongoing market rates in relation to deals for similar lot size.

**b) Sold securities to be deducted immediately from securities portfolio** - Immediately on sale, the corresponding amount should be deducted by the PD from its securities portfolio.

**c) Adequate system/checks mechanisms** - The retail transactions should also be subjected to concurrent audit.

## **6) Engagement of brokers for investment transactions**

**a) Brokerage charges to be clearly indicated on notes/memoranda put up to top management** - The brokerage on the deal payable to the broker, if any (if the deal was put through with the help of a broker), should be clearly indicated on the notes/memorandum put up seeking approval for putting through the transaction, and separate account of brokerage paid, broker-wise, should be maintained.

**b) Limited role of brokers** - If a deal was put through with the help of a broker, the role of the broker should be restricted to that of bringing the two parties to the deal together.

**c) Confidentiality to be maintained by brokers** - While negotiating the deal, the broker is not obliged to disclose the identity of the counter-party to the deal. On conclusion of the deal, he should disclose the counter-party and his contract note should clearly indicate the name of the counter-party.

**d) Settlement of deals to be between PDs and counter-parties and no broker's involvement** - On the basis of the contract note disclosing the name of the counter-party, settlement of deals between PDs and counter-parties viz. both fund settlement and delivery of security, should be directly between the counter-parties and the broker should have no role to play in the process.

**e) Panel of Approved Brokers to be reviewed every year** - With the approval of their top management, PDs should prepare a panel of approved brokers which should be reviewed annually, or more often if so warranted. Clear-cut criteria should be laid down for empanelment of brokers, including verification of their creditworthiness, market reputation, etc. A record of broker-wise details of deals put through and brokerage paid, should be maintained.

## **7) Accounting Standards for securities transactions**

**a) Costs to be recognized immediately as expenses** - Costs such as brokerage fees, commission or taxes, incurred at the time of acquisition of securities, should immediately be recognised and treated as part of the cost of acquisition of the security.

**b) Move towards fully Mark to Market** - PDs should adopt the practice of valuing all securities on fully mark to market basis which, at regular intervals, will facilitate the development of an active and healthy secondary market. The PDs should also follow the risk management guidelines, if any, issued by the RBI for their operations. It is further clarified that the marking to market exercise is primarily for serving the MIS and risk management purpose. With regard to the actual accounting adjustment, the adjustment may be carried out at the time of the statutory

audit of the financials or at the audit intervals specifically stipulated by the concerned regulators eg. Listed companies are required to get their accounts audited at quarterly intervals in terms of SEBI guidelines.

***c) Broken period interest should not be capitalised*** - Broken period interest paid to seller as part of cost on acquisition of Government and other securities should not be capitalised but treated as an item of expenditure under Profit and Loss Account. The PDs may maintain separate adjustment accounts for the broken period interest.

#### **8) Review and reporting of securities transactions**

***Review of securities portfolio*** - The PDs should undertake periodical, say monthly, review of their securities portfolio, which should, apart from other operational aspects of the portfolio, clearly indicate and certify adherence to laid down internal policy and procedures and Reserve Bank guidelines. The review should be placed before their Boards.

#### **9) Reconciliation of holdings of Govt. securities etc.**

PDs should furnish to the Reserve Bank the statement of the reconciliation of their securities transactions (held in own account, as also under Constituents account) as at the end of every accounting year duly certified by their auditors. Further, the statement should reach Reserve Bank within one month from the close of the accounting year. This requirement of certification of reconciliation statement may be suitably included by PDs in the letters of appointment issued to the external auditors, in future.

**10) Custodial functions, advisory services, merchant banking, broking service etc.-** The PDs should undertake such business in accordance with the guidelines/instructions issued by the relevant regulator viz. SEBI, apart from the relevant guidelines contained herein. In case of any transgression of the guidelines, the penal action taken by the regulator should be informed to RBI.

#### **11) Transactions on behalf of Constituents**

***a) Guidelines on Constituent SGL Account*** - The transactions on behalf of constituents and the operations in the Constituent SGL accounts should be conducted in accordance with the guidelines in the foregoing paragraphs as also the guidelines issued by RBI on the Constituent SGL accounts.

***b) Records on Constituent Account should be clear on transactions*** - In the case of transactions relating to constituents, all the relative records should give a clear indication that the transaction belongs to constituents and does not belong to PDs own account.

***c) Primary Dealers to be circumspect while acting as agent for client*** - The PDs should be circumspect while acting as agent of their clients for carrying out transactions in securities on behalf of clients.

***d) Client assets not to be used for proprietary purpose*** - PDs should not use the constituents' funds or constituents' assets for proprietary trading or for financing of another intermediary's operations.