

Trading of Government Securities on Stock Exchanges

BPD.PCB. Cir. 39 / 09.29.00 /2002-03

March 13, 2003

The Chief Executive Officers of all
Primary (Urban) Co-operative Banks

Dear Sir,

Trading of Government Securities on Stock Exchanges

With a view to encouraging wider participation of all classes of investors, including retail, in government securities, it has been decided to introduce trading in government securities through a nation-wide anonymous, order driven, screen-based trading system of the stock exchanges, in the same manner in which trading takes place in equities. This facility of trading of government securities on the stock exchanges, in the dematerialised mode only, would be available to banks in addition to the present NDS of the Reserve Bank, which will continue to remain in place.

2. Accordingly, the primary (urban) co-operative banks have the option to undertake transactions in dated Government of India (GOI) securities in dematerialised form on automated order driven system of the National Stock Exchange (NSE), The Stock Exchange, Mumbai (BSE) and Over the Counter Exchange of India (OTCEI) in addition to the existing mode of dealing through SGL accounts with Reserve Bank of India or Constituent SGL accounts with the designated entities such as Scheduled Commercial Bank/Primary Dealer/ State Cooperative Bank etc. as mentioned in our Circular UBD.No. BR. 47/ 16.26.00/ 2001-02 dated June 7, 2002. The scheme will subsequently be extended to GOI treasury bills and State Government securities.

3. Trading in the government securities on the exchanges will take place in the same manner in which the trading takes place in the equities (Capital Market) segment. The key elements of the stock exchange trading framework are :

- automated order driven system
- anonymous trade matching on price-time priority
- T+3 rolling settlement
- Intra-day multilateral netting of obligations
- Settlement of fund obligations through exchange clearing corporation / clearing house
- Settlement of securities through the depositories

As the trading facility on the above stock exchanges will operate in parallel to the present system of trading in government securities, the trades concluded on the exchanges will be cleared by their respective clearing corporations/clearing houses. However, trading members of the stock exchanges shall not be involved in the settlement process for any RBI regulated entity. All stock exchange trades of banks have to be settled either directly with clearing

corporation/clearing house (in case they are clearing members) or else through a clearing member custodian.

4. Banks, as institutional investors on the stock exchanges, can undertake transactions only on the basis of giving and taking delivery of securities. In other words, short selling of government securities, even on an intra-day basis, is not permissible.

5. With a view to facilitating participation on the stock exchanges within the regulations prescribed by RBI, SEBI and the exchanges, banks are being extended the following facilities:

(i) Open demat accounts with a bank depository participant (DP) of NSDL/CDSL in addition to their SGL/CSGL accounts with RBI.

(ii) Value free transfer of securities between SGL/CSGL and demat accounts is being enabled at Public Debt Office (PDO), Mumbai, subject to operational guidelines issued separately by our Department of Government and Bank Accounts (DGBA) to all SGL account holders.

6. The balances in government securities maintained by the banks in the depositories will be included for SLR purpose. Also, any shortfall in maintenance of CRR/SLR resulting from settlement failure (on either the NDS-OTC market or the stock exchanges) will attract the usual penalties.

7. The Boards of primary (urban) co-operative banks may take a conscious decision in regard to using the stock exchange platform for making investments in government securities in addition to the existing NDS-OTC market. As regulations of SEBI will also apply insofar as trading of government securities is concerned, the Board should frame and implement a suitable policy to ensure that operations are conducted in accordance with the norms laid down by RBI/SEBI and the respective stock exchange. Prior to commencing operations, the dealing officials should also familiarise themselves with the basic operating procedures of the stock exchanges.

Operational guidelines:

8. Banks should have proper internal control mechanism for transactions in Government securities as already advised in circular UBD. No. Plan. 13 / UB.81 /92-93 dated 15 September 1992. Banks should also put in place appropriate internal control systems catering to stock exchange trading and settlement before commencing operations on the exchanges. The back office arrangement should be such that trading on the NDS/OTC market and on the stock exchanges can be tracked easily for settlement, reconciliation and management reporting. Banks should, therefore, install enabling IT infrastructure and adequate risk management systems.

9. Only SEBI registered brokers who are authorised by the permitted exchanges (NSE, BSE or OTCEI) to undertake transactions in government securities can be used for placing buy/sell orders. A valid contract note indicating the time of execution must be obtained from the broker at end of day.

10. The dealing officials should independently check prices in the market or on the stock exchange screens before placing their orders with the brokers. The decision making processes cannot be delegated to brokers by the banks.

11. The transactions done through any broker will be subjected to the current guidelines on transactions done through brokers. A limit of 5% of total transactions (both purchases and sales) entered into by a bank during a year should be observed as the aggregate upper contract limit for each of the approved brokers as advised in the circular UBD.No.Plan. 74 /UB.81- 92/93 dated 17 May, 1993. Accordingly, an approved panel of brokers may be prepared every year after satisfying, inter alia, the following (a) SEBI registration (b) current membership of NSE/ BSE/ OTCEI (c) performance i.e. market turnover in the preceding year as certified by the exchanges (d) market reputation, etc.

12. Brokers/trading members shall not be involved in the settlement process; all trades have to be settled through clearing member custodians. Hence, it will be necessary for UCBs to enter into a bilateral clearing agreement with such service providers beforehand.

13. All transactions must be monitored with a view to ensuring timely receipt of funds and securities. Any delay or failure should be promptly taken up with the concerned exchange / authorities.

14. At the time of trade, securities must be available with the banks either in their SGL or in the demat account with depositories. Any sale on T+3 basis on the stock exchanges cannot be covered by a purchase on the NDS/OTC market (even on T+0) and subsequent transfer from SGL account to their demat account for effecting deliveries. Similarly, no sale is permitted on NDS/OTC on T+0 against pay-in of securities expected on T+0 on the stock exchanges. Further, the purchase transactions by banks should similarly be subject to availability of clear funds in their settlement accounts at the time of pay-in.

15. Any settlement failure on account of non-delivery of securities/ non-availability of clear funds will be treated as SGL bouncing and the current penalties in respect of SGL bouncing will be applicable. The stock exchanges will report such failures to the respective Public Debt Offices.

16. For the limited purpose of dealing through the screen based trading system of the stock exchanges the condition stipulated in paragraph 2(ii) of circular UBD.No.Plan.PCB.41/09.29.00/2001-2002 dated 20 April 2002 that UCBs should seek a Scheduled Commercial Bank, a Primary Dealer or a Financial Institution as a counter party while undertaking transactions in Government securities will not apply.

17. Banks should report on weekly basis to their Audit Committee of the Board, giving the details of trades on aggregate basis done on the stock exchanges and details of any "closed-out" transactions on the exchanges.

18. Banks should take all necessary precautions and strictly adhere to all instructions / guidelines issued by the Reserve Bank relating to transaction in Government securities as hitherto.

Please acknowledge receipt of this circular to our Regional Office.

Yours faithfully,

(Sudarshan Sen)
General Manager