RISK MANAGEMENT SYSTEMS

Introduction

A sound risk management system is integral to an efficient clearing and settlement obligation system with stock exchange and vis-à-vis between clients and stock broker. We are documenting risk containment measures that were obligatory by the exchanges and regulators.

We have put in place a comprehensive risk management system, which is constantly upgraded to pre-empt market and clients failures. The member broker ensures that trading client's obligations are commensurate with their networth.

Risk containment measures include capital adequacy requirements of clients, monitoring of clients performance and track record, stringent margin requirements, position limits based on capital, online monitoring of clients positions and automatic disablement from trading when limits are breached, etc. The procedures as outlined below provides a general background on the subjects of money laundering and terrorist financing summarizes the main provisions of the applicable anti-money laundering and anti-terrorist financing legislation in India and provides guidance and procedures on the practical implications of the Act.

These procedures are intended for internal use of the company as per the Exchange/SEBI requirements.

Risk Managements

Minimum Base Capital

A Clearing Member (CM) is required to meet with the Base Minimum Capital (BMC) requirements prescribed by Exchange before activation. The CM has also to ensure that BMC is maintained in accordance with the requirements of Exchange at all points of time, after activation.

Every CM is required to maintain BMC of Rs.50 lakhs with Exchange in the following manner:

(1) Rs.25 lakhs in the form of cash.
(2) Rs.25 lakhs in any one form or combination of the below forms:

(i) Cash
(ii) Fixed Deposit Receipts (FDRs) issued by approved banks and deposited with approved Custodians or clearing house
(iii) Bank Guarantee in favour of clearing house from approved banks in the specified format.
(iv) Approved securities in demat form deposited with approved Custodians.

In addition to the above MBC requirements, every CM is required to maintain BMC of Rs.10 lakhs, in respect of every trading member(TM) whose deals such CM undertakes to clear and settle, in the following manner:

(1) Rs.2 lakhs in the form of cash.

(2) Rs.8 lakhs in a one form or combination of the following:

(i) Cash
(ii) Fixed Deposit Receipts (FDRs) issued by approved banks and deposited with approved Custodians/Exchange.
(iii) Bank Guarantee in favour of Exchange from approved banks in the specified format.
(iv) Approved securities in demat form deposited with approved Custodians.

Any failure on the part of a CM to meet with the BMC requirements at any point of time, will be treated as a violation of the Rules, Bye-Laws and Regulations of Exchange and would attract disciplinary action inter-alia including, withdrawal of trading facility and/ore clearing facility, closing out of outstanding positions etc.

Additional Base Capital

Clearing members may provide additional margin/collateral deposit (additional base capital) to Exchange and/or may wish to retain deposits and/or such amounts which are receivable from Exchange, over and above their minimum deposit requirements, towards initial margin and/ or other obligations.

Clearing members may submit such deposits in any one form or combination of the following forms:

(i) Cash
(ii) Fixed Deposit Receipts (FDRs) issued by approved banks and deposited with approved Custodians or Exchange.
(iii) Bank Guarantee in favour of Exchange from approved banks in the specified format.
(iv) Approved securities in demat form deposited with approved Custodians.

Cash deposit and non cash deposit made by the member should be in ratio of 50:50. Only approved securities are accepted by the exchange after deducting applicable haircut.

a. Margins

Exchange has developed a comprehensive risk containment mechanism for the Futures & Options segment. The most critical component of a risk containment mechanism for SEBI is the online position monitoring and margining system. The actual margining and position monitoring is done on-line, on an intra-day basis. SEBI uses the SPAN (Standard Portfolio Analysis of Risk) system for the purpose of margining, which is a portfolio based system

1. Computation of Margins:

a. VaR Margin :

As mandated by SEBI, the Value at Risk (VaR) margining system, which is internationally accepted as the best margining system, is applicable on the outstanding positions of the Clients in all scrips.

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 Member to liquidate the position over three days. This leads to a scaling factor of square root of three for illiquid stocks.

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. Computation of the VaR margin requires the following definitions:

- **b. Scrip sigma** means the volatility of the security computed as at the end of the previous trading day. The computation uses the exponentially weighted moving average method applied to daily returns in the same manner as in the derivatives market.
- **c. Scrip VaR** means the higher of 7.5% or 3.5 scrip sigmas.
- **d. Index sigma** means the daily volatility of the market index (S&P CNX Nifty or BSE Sensex) computed as at the end of the previous trading day. The computation uses the exponentially weighted moving average method applied to daily returns in the same manner as in the derivatives market.
- **e. Index VaR** means the higher of 5% or 3 index sigmas. The higher of the Sensex/Nifty VaR or Nifty VaR would be used for this purpose.

The VaR Margins are specified as follows for different groups of stocks:

Liquidity Categorization	**One-Day VaR**	**Scaling factor for illiquidity**	**VaR Margin**
Liquid Securities (Group I)	Scrip VaR	1.00	Scrip VaR
Less Liquid Securities (Group II)	Higher of Scrip VaR and three times Index VaR	1.73 (square root of 3.00)	Higher of 1.73 times Scrip VaR and 5.20 times Index VaR
Illiquid Securities (Group III)	Five times Index VaR	1.73 (square root of 3.00)	8.66 times Index VaR

b) The VaR margin is collected on an upfront basis by adjusting against the total liquid assets of the Clients at the time of trade.

c) The VaR margin is collected on the gross open position of the Client. The gross open position for this purpose is the gross of all net positions across all the clients of a member including his proprietary position.

d) For this purpose, there would be no netting of positions across different settlements.

e) Dissemination of Information :

The VaR amount applicable in respect of the scrips would be disseminated on the website of the Exchange on a daily basis.

b. Mark to Market Margin (MTM) :

1. The MTM margin is collected on the gross open position of the Client. The gross open position for this purpose would mean the gross of all net positions across all the trade of a Client. Further, there is no netting across two different settlements.

2. There is no netting off the positions and setoff against MTM profits across 2 rolling settlements i.e. T day and T-1 day. However, for computation of MTM profits/losses for the day, netting or setoff against MTM profits is permitted.

c. Extreme Loss Margin

The term Extreme Loss Margin replaces the terms "exposure limits" and "second line of defence" that have been used hitherto. It covers the expected loss in situations that go beyond those envisaged in the 99% value at risk estimates used in the VaR margin.

(i) The Extreme Loss Margin for any stock is higher of:

- 5%, and
- 1.5 times the standard deviation of daily logarithmic returns of the stock price in the last six months. This computation is done at the end of each month by taking the price data on a rolling basis for the past six months and the resulting value is applicable for the next month.

(ii) The Extreme Loss Margin is collected on the gross open position of the Client. The gross open position for this purpose means the gross of all net positions across all the clients of a member including his proprietary position.

(iii) For this purpose, there is no netting of positions across different settlements.

c. **Special Margin:**

Special margin may be imposed by the Exchange, from time to time on certain scrips as a surveillance measure and informed to the members through notices.

2. **Collection of Margins.**

All statements pertaining to daily margins viz., VaR, MTM, ELM and Special Margin computed by the Exchange on the outstanding positions of the members/Clients are available for downloading by them in their back –offices at the end of the day.

3. **VaR Margin.**

The VaR margin is collected on an upfront basis by adjusting against the total liquid assets of the member at the time of trade.

4. **Mark to Market Margin (MTM) :**

The mark to market margin (MTM) is computed after trading hours on T day on the basis of closing price, of that day. In case the security has not been traded on a particular day, the latest available closing price is considered as the closing price. MTM margins is also recomputed in respect of all the pending settlements on the basis of closing prices of T day and the difference due to increase/decrease in MTM margins on account of such recomputation is adjusted in the MTM obligation of the Client for the day. Such MTM is collected from the Client in the evening on the T day itself, first by adjusting the same from the available cash and cash equivalent component of the liquid assets and the balance MTM in form of cash from the Client.

6. **Special Margins:**

The Special Margin as applicable is collected along with MTM from the Client, first, by adjusting the same from the available liquid assets and the balance Special Margin in form of cash from the Client on the same day.

7. **Extreme Loss Margin (ELM):**

- The Extreme Loss Margin is collected/ adjusted from the total liquid assets of the Client on a real time basis available with Broker Member.

8. **Release of margins:**

The above-referred margins so collected are released on completion of pay-in of the settlement and same credit with respective client account on same day.

Initial Margin

Exchange collects initial margin up-front for all the open positions of a CM based on the margins computed by Exchange. A CM is in turn required to collect the initial margin from the TMs and his respective clients. Similarly, a TM should collect upfront margins from his clients.

Initial margin requirements are based on 99% value at risk over a one day time horizon. However, in the case of futures contracts (on index or individual securities), where it may not be possible to collect mark to market settlement value, before the commencement of trading on the next day, the initial margin may be computed over a two-day time horizon, applying the appropriate statistical formula. The methodology for computation of Value at Risk percentage is as per the recommendations of SEBI from time to time.

Initial margin requirement for a member:

a. For client positions - shall be netted at the level of individual client and grossed across all clients, at the Trading/ Clearing Member level, without any setoffs between clients.

b. For proprietary positions - shall be netted at Trading/ Clearing Member level without any setoffs between client and proprietary positions.

For the purpose of SPAN Margin, various parameters are specified from time to time to collect margin from clients to meet the norms of SEBI/Exchanges.

In case a trading member wishes to take additional trading positions his CM is required to provide Additional Base Capital (ABC) to Exchange. ABC can be provided by the members in the form of Cash, Bank Guarantee, Fixed Deposit Receipts and approved securities.

Premium Margin

In addition to Initial Margin, Premium Margin would be charged to members. The premium margin is the client wise margin amount payable for the day and will be required to be paid by the buyer till the premium settlement is complete.

Assignment Margin

Assignment Margin is levied on a CM in addition to SPAN margin and Premium Margin. It is required to be paid on assigned positions of CM’s towards Interim and Final Exercise Settlement obligations for option contracts on individual securities, till such obligations are fulfilled.

The margin is charged on the Net Exercise Settlement Value payable by a Clearing Member towards Interim and Final Exercise Settlement and is deductible from the effective deposits of the Clearing Member available towards margins.

Assignment margin is released to the CMs for exercise settlement pay-in.

Margin Reports

The following margin reports are downloaded to members on a daily basis:

- Margin Statement of Clearing Members : MG-09
- Margin Statement of Trading Member/ Custodial Participant : MG-10
- Margin Payable Statement of Clearing Member : MG-11
- Detail Margin File of Clearing Members : MG - 12
- Client Level Margin File of Trading Members : MG-13

Client Margin Reporting

Clearing Members (CMs) and Trading Members (TMs) are required to collect upfront initial margins from all their Trading Members/ Constituents.

CMs are required to compulsorily report, on a daily basis, details in respect of such margin amount due and collected, from the TMs/ Constituents clearing and settling through them, with respect to the trades executed/ open positions of the TMs/ Constituents, which the CMs have paid to Exchange, for the purpose of meeting margin requirements.

Similarly, TMs are required to report on a daily basis details in respect of such margin amount due and collected from the constituents clearing and settling through them, with respect to the trades executed/ open positions of the constituents, which the trading members have paid to the CMs, and on which the CMs have allowed initial margin limit to the TMs.

Formats of files to be submitted by members and return files sent by Exchange.

Due date for Margin Reporting

The cut off day upto which a member may report client margin details to the Exchange is referred to as the sign off date. It shall be 2 working days after the trade day.

Non submission of Client Margin Reporting Files

- In consultation with BSE, MCX-SX, NSE and USE, SEBI has decided that Stock Exchanges shall levy penalty specified hereunder on trading members for shortcollection/non-collection of margins from clients in Equity and Currency Derivatives segments:

For each member	
‘a’	**Per day Penalty as %age of ‘a’**
(< Rs 1 lakh) And (< 10% of applicable margin)	0.5
(≥ Rs 1 lakh) Or (≥ 10% of applicable margin)	1.0

Where a = Short-collection/non-collection of margins per client per segment per day

- If short/non-collection of margins for a client continues for more than 3 consecutive days, then penalty of 5% of the shortfall amount shall be levied for each day of continued shortfall beyond the 3rd day of shortfall.
- If short/non-collection of margins for a client takes place for more than 5 days in a month, then penalty of 5% of the shortfall amount shall be levied for each day, during the month, beyond the 5th day of shortfall.
- Notwithstanding the above, if short collection of margin from clients is caused due to movement of 3% or more in the index (close to close value of Nifty/Sensex for all equity derivatives) and in the underlying currency pair (close to close settlement price of currency futures, in case of all currency derivatives) on a given day, (day T), then, the penalty for short collection shall be imposed only if the shortfall continues to T+2 day.
- All instances of non-reporting shall amount to 100% short collection and the penalty as applicable shall be charged on these instances in respect of short collection.
- If during inspection it is found that a member has reported falsely the margin collected from clients, the member shall be penalized 100% of the falsely reported amount along with suspension of trading for 1 day in that segment.
- The penalty shall be collected by the Stock Exchange within five days of the last working day of the trading month and credited to its Investor Protection Fund.

b. Margins collection from Client

As per SEBI mandate, Trading Members should have a prudent system of risk management to protect themselves from client default. Margins are likely to be an important element of such a system. The same are therefore well documented and be made accessible to the clients and the Stock Exchanges. As per SEBI, the quantum of these margins and the form and mode of collection are left to the discretion of the members brokers. To ensure ourselves from risk and perils of the market, SW has also its risk management parameters and have broadly divided the clients into followings categories; for the purpose of their margin obligation and exposure set out automatically against their balances into the systems.

a. General clients not falling under any of following categories

   Margin requirements as per exchange will be applicable and collected from clients before executing any trade on behalf of clients.

b. Clients paying the cheques in High value

   Those clients who are maintaining following types of accounts will be given relaxation subject to final approval from the management to pay the settlement obligation immediately next day;

   - Bank Account with anywhere banking facility;
   - Bank Account with at Par cheque Book facility
   - Internet Banking
   - Account with Priority Banking Facilities

c. Clients keeping credit balance with us.

   The client who is having sufficient credit balance in their consolidated trading accounts (which includes BSE/NSE-Cash, NSE-F&O, MCXSX, MCX, NCDEX segments etc) to cover their upfront margin, as applicable on day to day basis will be blocked to the extent margin available with us. The final payment will be released only after squiring off of positions with the exchange and, full and final settlement of accounts.

d. Clients referred by the Management.

   The clients who are referred by the management and/or to whom management knows them better will be allowed to trade taking into accounts the managements accounts group balance, across the segment.

e. Clients of Sister/Group concerns.

   All sister concerns/group concerns of promoter and promoters groups companies will not be require to keep any margin with us in CM segment. However, in FNO segment, they should also meet the margin requirement of the exchange. Member may assist to its group companies in contingencies/ or unavoidable circumstances.

f. Clients of same or similar groups

   Clients which are forming part of similar groups or families will be considered for margin across to their group/family accounts credits and holdings.

g. Clients keeping shares in Clients Beneficiary accounts.

   The client whose shares are transferred to client beneficiary account maintained in our own depository will also be exempt from the requirement of upfront margin collection subject to that their underlying shares in our demat is not less then 10% of the total value of shares traded.

Limit Set

Case No. 1

If there is Pure Ledger Credit than Limit will be 4 Times.

Exp: If the Ledger Balance is Credit of Rs. 1 Lacs than Limit will be Rs. 4 Lacs for Buy and Sell. So margin =1 lacs & Exposure = 4 lacs.

Case No. 2

If there is Pure Credit Balance + Paid Stock Limit will be 4 times (on stock after hair cut)

Exp : If the Ledger Balance is Credit of Rs. 1 Lac + Stock of Rs. 1 Lacs (after Hair cut) Limit is on Stock value is Rs. 50,000/- than Limit will be on Ledger Balance + Stock I.e. Rs, 1.50 Lacs limit will be 4 times i.e. 6 lacs on both sides.
So margin =1.5 lacs & Exposure = 6 lacs

Case No. 3

If there is Pure Loss in Account than Limit will be Zero

Case No. 4

If there is Pure Ledger Debit + Stock (Approved Stock is Greater than the Ledger Debit) than Limit (After Hair Cut) will be on Stock Value but after deducting the Ledger Debit limit will be 4 times

Exp: If the Ledger Balance in a Pure Debit of Rs. 1 Lacs, but the Stock of Rs. 10 Lacs than after hair cut (35 % haircut) the value of that stock is Rs. 6.5 Lacs than after adjusting the Debit Balance in a Ledger of Rs. 1 Lacs, limit of 4 times of 5.5 lacs (after hair cut of stock value 6.5 lacs – ledger debit 1 lacs) i.e. 22 Lacs will be available on both sides.
So margin =5.5 lacs & Exposure = 22 lacs

Case No. 5

If the Ledger Balance is Zero, but the paid stock (Approved Stock) than limit will be (after hair cut) 4 times

Exp: If the Ledger Balance is a Zero limit on stock after hair cut accordingly i.e. 4 times will be available. If the Stock of Rs. 10 Lacs than after hair cut the value of that stock is Rs. 6.5 Lacs than after adjusting limit of 4 times of 6.5 lacs ,i.e. 26 lacs will be available on both sides
So margin =6.5 lacs & Exposure = 26 lacs

Case No. 6

For F&O segment limit will be as per credit balance 1 time i.e. if the ledger balance is 1 Lacs in credit then client can trade up to 1 Lacs margin.

Exp: The NIFTY margin is 33000/- and credit in ledger is 1 lacs then client can buy 3 NIFTY. If client wants to buy RENUKA and margin for the same is 125000/- then client can not buy.

Risk Management System (RMS)

1. Daily Limit Setting through RMS Software.

2. Dealers will be able to view the holding of the clients in their front office system.

3. Intraday limit in cash segment will be increased till 15 times with strictly Timer Auto Square.

4. Day to Day recover phone calls go to the sub-brokers or the end clients of ours for margin shortfalls and T+2 Delivery payments.

5. We have Timer Auto Square up Facilities. In which whenever the market is highly volatile our RMS Team can take decision of compulsory square up all the open position at any point of time during the market hours.

6. We have MTM Auto Square up Facilities. In which we have to specify that when the Mark to Mark Loss reaches at 90 % the system will square its open position automatically.

7. T, TS and Z group securities not be allowed for trading .It could be done with special approval and 100% margin in the account. No leverage should be allowed on any condition.

8. Securities which has been debarred and suspended by Sebi and exchanges will be immediately suspended in our system.

9. Any shortfall of margins will attract delayed payment charges of 18% p.a.

10. All limit settings will be according to the market condition.

11. We also avoid trading in a physical share.

c. RMS Parameters through systems for online Trading and monitoring.

a. The Branch logins are provided through an automated Trading Platform supported by Hitech Technology of monitoring the clients trading through these software.
b. SW Uses ODIN software for Branch level Trading and /or NSE's NOW software which are highly compatible and easy to monitor
c. The RMS parameters are set out automatically through systems generated parameters set-out in Back-office software on day to day basis.
d. The limits are set automatically to each individual clients trading through any modes of Trading Platform.
e. Compliance action is automated for defaulting clients by squaring off their trades automatically at the end of given relaxation period to clear their dues.
f. The RMS process is monitored and evaluated for intra-day trading of the each individual clients, SW uses Reliable online RMS software to track such status.
g. SW believes in upgrading their RMS systems at every stage and every day to avoid any loops into the systems. Though the risk in stock market is not ruled out what we ensure to keep ourselves alive and SEBI compliant.

d. RMS Parameters through systems for Offline and monitoring

a. SW has system to monitor client position on day to day basis offline also.
b. The client having open position with member broker asked by the broker member to meet margin obligation on day to day basis.
c. In case of client have debit balance the broker member give intimation to the clients to clear the debit balance.
d. If the client has not fulfilled the margin obligation, then the SW inform the client that if they will not meet the obligation till certain time SW will squire off their position as compliance action.

For SW Capital Pvt. Ltd.

Sd/-
Director