**Executive Director**

**Secondary Market Department-II**

SMDRP/POLICY/CIR-04/2000

January 20, 2000

To,

**The Executive Directors/Presidents/Managing Directors**

**of all the Stock Exchanges**

Sir,

# Guidelines for market makers

With a view to study the concept of "Market Making" and to draft operational procedures for market making, eligibility criteria for Market Makers, risk containment measures, etc, SEBI constituted a Committee on March 24, 1998 under the chairmanship of Shri G P Gupta, then Chairman, UTI and current Chairman and Managing Director of IDBI. The Committee submitted its report to SEBI on August 31, 1999 vide letter No. SMDRP/Policy-MM/19336/99. A copy of the report was sent to you on October 07, 1999. The guidelines for the market makers based on the recommendations of the Committee are enclosed.

The market maker would operate under the regulatory framework as envisaged and laid out herewith in these guidelines .The Exchanges have been accorded flexibility to make modifications to their schemes to make it more attractive to the Market Makers to take up commitments under the schemes, however, the terms of selection of scrips, the capital adequacy norms and the risk containment measures such as the price bands and margins would not be altered from those stipulated in these guidelines.

The exchanges shall explore the possibility of their clearing banks opening special cells in the bank for providing funds to the market makers and creating a corresponding lien on the shares held/traded by the market makers.

The list of the scrips eligible for market making on the exchange should be forwarded to SEBI for information and any subsequent changes in the scrips should be incorporated in the Monthly Development Reports of the exchanges.

Yours faithfully,

**M. D. PATEL**

Encl:  as above

# Guidelines for Market Makers

Over the past several years the securities market has witnessed a sea change. The market has become more modern in terms of infrastructure, adoption of best international practices and introduction of competition. With the maturity of the regulatory framework and increased market surveillance, the market has also become safer and investor is better protected. The extensive reforms introduced by SEBI over the last few years have enhanced the integrity, transparency and efficiency of the operations of the securities market. The introduction of electronic trading and "order matching" system in all the stock exchanges, have led to reduction in transaction costs, speedier execution of trades and gains in liquidity. The, spreads have dropped by a factor of 10 and volumes have risen a hundred fold in respect of many shares. Increase in trading volume on the exchanges, however, has not been reflected always in the liquidity of all the listed shares. There are a large number of shares that are not actively or frequently traded although many of them have some fundamental strength and intrinsic value. The introduction of market making facility for such shares could be a possible means to infuse liquidity in such shares.

In the year 1993 guidelines for the Market Makers were issued vide our circular no.SMD/SED/93/11362 dated August 05, 1993. However, the scheme did not elicit adequate response. With a view to study the concept of "Market Making" and to draft operational procedures for market making, eligibility criteria for Market Makers, risk containment measures, etc, SEBI constituted a Committee on March 24, 1998 under the chairmanship of Shri G P Gupta, then Chairman, UTI and current Chairman and Managing Director of IDBI. The Committee submitted its report to SEBI in August 31, 1999.

The Market Maker would operate under the regulatory framework as envisaged and laid out herewith in these guidelines. The Exchange would act as a SRO for the purposes of monitoring and effective operations of the Market Makers. The Exchanges have been accorded flexibility to make modifications to the scheme to make it more attractive to the Market Maker to take up commitments under this scheme, however, the terms of selection of scrips, the capital adequacy norms and the risk containment measures such as the price bands and margins would not be altered from those stipulated in these guidelines.

**Criterion for selection of scrips for Market Making**

The stock exchanges shall formulate its own benchmarks for selecting the scrips for market making, however, the shares satisfying any of the following criteria would not be eligible for market making :-

- Shares included in the BSE Sensex of the Stock Exchange, Mumbai and the S&P CNX Nifty of the NSE;
- Share where the average number of trades is more than 50;
- Shares where the value of trades on a daily basis is more than Rs.10,00,000/-;
- Shares where the company is not in operation and the networth erosion is beyond 50%

The list of scrips eligible for market making shall be reviewed by the exchanges so as to shift the scrips from one category to the other, after an observation period of two-three months to ensure permanence in the trend.

The market making would be on a voluntary basis for these shares. But, if Market Maker is not available for such shares, the share will continue to be traded under the existing system.

Exclusivity of Market Makers

If a share is eligible for market making and Market Makers are available, then, the share would trade only under a quote driven system and all orders must flow through Market Makers.

Number of Market Makers for each share

There would not be more than five Market Makers in any of the eligible shares on an exchange who will be selected on the basis of objective criteria to be evolved by the Exchange which would include capital adequacy, networth, infrastructure, minimum volume of business etc.

Qualifications for a registered Market Maker

Any member of the Exchange would be eligible to act as Market Maker provided he meets the criteria laid down by the exchange. The member brokers desirous of acting as Market Maker in the eligible scrips shall apply to the concerned stock exchange for registration as Market Makers.

**The obligations and responsibilities of Market Makers**

The Market Maker shall fulfil the following conditions to provide depth and continuity in trading the shares :

(a) The Market Maker shall be required to provide a 2-way quote on a continuous basis;

(b) The minimum depth of the quote shall be Rs.5,000/- or one market lot whichever is higher;(in case of demat shares, for which there is no market lot, the same market lot as existed in the physical segment would be applicable for this purpose.)

(c) The quote shall be provided in such a way that the quotes are not absent from the screen for more than 30 minutes at a time;

(d) Execution of the order on a continuous basis at the quoted price and quantity must be guaranteed by the Market Maker;

(e) the Market Maker must give commitment to buy and sell shares upto a certain quantity in which they make markets;

(f) The Market Maker will be eligible to change quotes even if no transaction has been executed at the displayed quote. In any case the obligation of the Market Maker will end at 1% less than the circuit filter limits;

(g) The Market Maker may compete with other Market Makers for better quotes to the investors;

(h) Once registered as a Market Maker, he has to start providing quotes within 5 trading days of registration and shall be subject to the guidelines laid down for market making by the exchange.

(i) Once registered as a Market Maker, he has to mandatorily act in that capacity for a minimum period of three months.

Rights of the Market Maker

The Market Maker has the right to information about the share, in which he is making the market including the availability of trading and financial information, performance of the company in the last three years, etc. on a continuous basis.

Voluntary De-registration

The Market Makers may be allowed to de-register voluntarily from a particular share(s) provided it has fulfilled its obligations for a minimum period of three months and a one-month notice is given to the exchange.

Compulsory De-registration

If a Market Maker fails to fulfil his obligations as a Market Maker for more than three consecutive trading days, he will automatically stand de-registered from that share and may not be permitted to act as a Market Maker for any other security for a minimum period of three months

Dissemination of Information

a) The exchange should disseminate a list of Market Makres in a share to the public

b) Exchange should disseminate the price and volume of turnover in shares eligible for market making.

Number of Shares per Market Maker

The number of companies in whose shares a Market Maker would make market should be linked to his capital adequacy.

Risk Containment Measures and monitoring for Market Makers

Margins

All applicable margins should be levied and collected without any waiver/exemption.

Capital Adequacy

The exchanges would prescribe the capital adequacy requirement for its members commensurate with a number of companies in which Market Maker proposes to make market, the type of shares, and keeping in mind that the Market Maker works against the market and thus bear the brunt of the adverse trend. The monitoring of this requirement would be done by the exchange and any violation of this requirement would be liable for punitive action to be taken by the Disciplinary Action Committee (DAC) of the Exchange, which may also include monitory penalty apart from the trade restriction as decided by the DAC. An exchange may lay down additional criteria also for Market Makers as risk containment measures.

Price Band and Spreads

There would be no change to the circuit filters or price bands, which are imposed by SEBI from time to time for the shares in which market making is available. The spreads between the bid and ask price would be as follows:-

For shares priced

| | | |
|---|---|---|
| Upto Rs 10 | - | no limit on spreads |
| >Rs. 10 and upto Rs 20 | - | 10% maximum spread |
| >Rs. 20/- and upto Rs.50/- | - | 5% maximum spread |
| >Rs.50/- and upto Rs. 100/- | | 4% maximum spread |
| >Rs. 100/- | - | 3% maximum spread |