

CODE OF CONDUCT FOR USING RBI'S "NEGOTIATED DEALING SYSTEM – ORDER MATCHING (NDS-OM)" – Dated October 1st 2011

(The contents of the code are also applicable to Voice-Based deals done and reported on PDO –NDS).

Preamble:

The Negotiated Dealing System–Order Matching System (NDS-OM), hereinafter referred to as the "System" is an anonymous electronic order matching platform, owned by RBI. The System was launched on August 1, 2005. The system facilitates secondary market trading in all kinds of Central Government securities, State Government securities, Special securities and Treasury Bills. The system is hosted and maintained by the Clearing Corporation of India Limited (CCIL) for and on behalf of RBI.

The System users place their bids and offers on the NDS-OM screen. The system matches all bids and offers on price/time priority or yield/time priority that is, within the orders of the same price or yield (as applicable), it matches the oldest order first. For example, if, for 7.80 % Government Security 2021, there are two bids of Rs. 5 crore each at price Rs 96.50, one put at 9.30 am, and another at 9.45 am, the bid at 9.30 am will get priority for matching or for executing the trade of a seller who wants to sell at the bid –price. As soon as the order placed at 9.30 am has been filled/executed/dealt upon/ matched, the bid placed at 9.45 am gets the priority. In case there is a bid for a price higher than Rs 96.50 at 9.45 am, the higher price, though put at a later time, would get priority. Similar time priority logic applies for offers /sell orders with the lowest price/yield offered always getting the highest priority.

The system ensures complete anonymity among participants as counterparty information is not available to any of the system participants. The System operates in a straight through processing (STP) environment viz., all trades concluded on the system flow directly to CCIL for settlement. CCIL acts as the central counterparty (CCP) for settlement of all trades concluded on the system subject to its Bye Laws, Rules and Regulations.

Access to the system is available only to those entities that have been granted membership by RBI. Others can access it through any of the system members with whom the former hold their gilt and fund accounts.

The system ensures complete anonymity about participants and, therefore, ensures fair pricing. The anonymity of the system gives an opportunity to the larger players to execute their orders without the prices moving adversely against them.

The system provides both pre-trade and post-trade information and on real-time basis. This ensures transparency and better price discovery as against the voice-market (direct or brokered), where there could be a time delay in information dissemination.

Trading happens in standardized lot size of Rs. 5 crore, and in multiples of Rs. 5 crore, providing enough liquidity in the system.

To facilitate trading in small lot sizes of less than Rs. 5 crore, a separate 'odd lot' segment - with the minimum trading lot size being only Rs. 10,000/- (for dated securities) and Rs. 25000/- (for Treasury Bills) is also available in the system. Participants get to know the depth of the market as the system shows the order depth in terms of number and total amount of sell/buy orders for each security.

The trade details (time stamp, name of the security, quantity traded, price, and yield) are disseminated through the NDS-OM webpage hosted on CCIL's website <http://www.ccilindia.com/OMHome.aspx>.

The System has inbuilt security features (pop-ups) which a User has to pass through before a Buy or Sell order is placed on it. Each pop-up, gives sufficient warning to the User reminding him about the nomenclature of the security, clean price, YTM etc, based on the data input by the User.

The system has a user hierarchy structure which decides role based access privileges to the system i.e., whether a user has dealing rights or not or whether the user is a back office or mid office user in which case he would not enjoy dealing rights. Even for a dealer, the system facilitates various controls such as only bids or only offers operate only on the proprietary book or on the client book or both. These decisions are to be input by the respective Head of Treasury in the system based on specific internal requirements.

Heads of Treasuries/Chief Dealer can also set the maximum Single Order Limit in respect of each Dealer. Apart from acting as a prudent internal risk control mechanism, this feature also helps in minimizing errors in inputting the quantity. The Head of Treasury also has the option to allow/disallow a Dealer to short sale.

Code of conduct for usage of NDS –OM system:

This Code of Conduct, hereinafter referred to as the “Code”, seeks to lay down directives to the users of NDS-OM system, so that the anonymity, ease of dealing and settlement, provided by the System are not mis-utilised for misleading or misinforming the market, and deals resulting into large losses or undue enrichments are not undertaken. ***Floating Rate Bonds, Treasury Bills and Cash Management Bills are kept out of this Code for the present.***

1. Heads of Treasuries (HoTs) should ensure that users accessing the system are duly authorized. Procedures laid down to prevent unauthorized access to the system (User ID, passwords) etc should be properly followed to prevent abuse of the system.
2. New Dealers, authorized to use the System should be trained for at least 15 days, before being allowed to handle the System. Users are required to acquaint themselves with the NDS-OM guidelines and related RBI guidelines/procedures.

3. Users of the system shall observe high standards of integrity and just and fair principles of trading while trading either on their own account or on behalf of their clients.
4. Users are required to use the security features inbuilt in the system. They should appreciate the features such as high-speed trading and STP for settlement which the system provides, and the fact that by ignoring the in-built security features, the users are susceptible to committing 'costly' (sometimes in lakhs of rupees) mistakes.
5. Any loss arising out of trades executed by ignoring the system alerts and the internal filters would have to be borne by the user/entity.
6. Bids/Offer placed on the System, should be free from market manipulation and fraudulent practices. Examples of such bids and offers are :
 - i) The practice of entering into arrangements for sale or purchase of a Government security where there is no change in beneficial interests or market risk or where the transfer of beneficial interest or market risk is only between parties who are acting in concert or collusion.
 - ii) Deliberately trying to manipulate the prices of infrequently traded securities at quarterly/annual closing dates.
 - iii) Deliberately putting wide bids and offers on the NDS- OM for the frequently traded securities, such that the party buying or selling at the price displayed commits a "Big-Figure" mistake.

(Example: A security has last traded at Rs. 90.56. If the next offer is put at Rs. 91.56 or Rs. 91.57 by a seller or next bid is placed at Rs. 89.55 or Rs. 89.56 either deliberately or erroneously, any party doing a trade at such prices would be committing a "big-figure" mistake.)

Explanation:

a) In the above example, if the market continues to trade one big – figure higher or lower, after the first big –figure change deal,(on account of some market –event), the subsequent deals *would not be considered as big –figure error deals* .

b) Placing a wide bid/offer at the start of the day, though within the price –band applicable for the day would not constitute as misleading the market to commit “Big – Figure” mistakes.

(However,” Market Makers” are expected to open the market with narrow bids and offers, unless there is an event warranting wider spreads within the “price-band” set. At the same time “Market Takers” are expected to be more cautious while dealing at opening prices, which are wide)

Procedure for reversal of trades with big –figure mistakes done on NDS-OM:

(i) Big-Figure Mistakes : Some illustrative examples of big-figure mistakes are as under :

- *An offer is put at Rs.91.56 or Rs.91.57 for a security that was last traded at Rs.90.56. Once the offer is hit by mistake without realizing the change in the big figure, it would be considered as a “Big-figure” mistake by the buyer. The market, however, reverts to bids and offers at around Rs. 90.56 after the erroneous trade.*
- *A security was last traded at Rs. 96.50, and the next bid is placed at Rs 95.52. If the bid is hit by a seller by mistake without realizing the change in the big figure, such mistakes would be considered as, “big-figure” mistakes. The market reverts to bids and offers around Rs.96.50 after the erroneous trade.*

- (ii) A bid or offer placed within the price band set under the code of conduct, (either side of FIMMDA's previous day's closing price) at the start of the day, **would not constitute a "Big-Figure " mistake**, as markets can "gap", at such times.

The "Code" enjoins upon the users not to deliberately put such wide bids and offers from the ongoing market rates (on the NDS- OM) that can lead other users to commit "Big-figure" mistakes. ***In case big-figure mistake trades get executed, the following procedure should be adopted to ensure that no undue enrichment and/or losses occur to either of the counterparties:***

- a. The party which notices the big-figure error, (irrespective of whether the party has lost or gained due to the big –figure error) should immediately inform FIMMDA about such a deal. On being informed about the name of the counterparty, the off-market deal should be reversed as early as possible.
- b. As far as possible, a reversal deal should be put through on the same day, on the PDO-NDS, for the same security, same amount (face value), and at the same price. In case this is not possible; the difference should be settled in cash the next day.
- c. Both the counterparties should inform FIMMDA about the reversal transaction on the same day latest by 6.00 pm. In respect of cash settlement on the next day, the same should be informed to FIMMDA at the earliest, but not later than the market closing hours on the same day.

(The above reversal methodology is suggested, as erroneous trades done on the NDS-OM can be reversed only through PDO –NDS. On the other hand, such erroneous deals, if done over the Voice –based system should be corrected before reporting on the PDO-NDS)

- 7. Use of internal filters:** The System provides for price filters/Single Order Limit/Short Sale checks to be put in place, in each individual terminal of a Dealer. Any loss arising out of ignoring/overriding the filter would have to be borne by the user entity.
- 8. Placement of Internal Filters (IF) on the System/ Setting the Trading Range for the Day :** At the start of the day, a *maximum IF* of 1 per cent or 1.25 per cent (bond-specific) for Bids/Offers for the day, should be placed over the previous day's FIMMDA closing valuation prices of all securities (*example: If the closing valuation price of 7.80% GS 2021, is Rs. 96.89 on June 23, 2011, an IF of 1.00 per cent would be at Rs.95.92 –Rs. 97.86 for June 24, 2011*).The IF would also set the price band/range for the day. In the previous example, the IF being at Rs.95.92 – Rs. 97.86, the market should not move beyond this range for 7.80 % - 2021, on June 24, 2011)

Under normal circumstances, market participants should not breach the price band/range during the course of the day, either on the NDS-OM or on the PDO-NDS.

Individual users are free to set lower filters say, 60 paise or lower for successive or opening trades, to avoid “Big-Figure” mistakes and undue losses/undue enrichment. ***This facility is already available on the NDS-OM.***

Securities which can have a maximum IF of 1.00 per cent would be the ones which have been identified as liquid securities for the purpose of short-selling by FIMMDA.

(Example: The liquid securities identified by FIMMDA for short-selling for the month of June 2011 were a. 7.83% GS 2018 b. 7.80% GS 2021 c. 8.08% GS 2022 & d. 8.13% GSI 2022. *Only these securities would be eligible for an IF of 1.00 per cent for June 2011*)

All other securities (excluding FRB, T-Bills, and CMBs), can have a maximum IF of 1.25 per cent.

Note: All SGL account holders providing gilt account facility, should instruct their clients (Gilt Account Holders) not to place requests with the custodians for purchase/sale of Government securities at prices outside the day's price band

Price-Band for days when there is a scheduled auction of Government Securities:

It is appreciated that on days when there is either primary auction or OMO auction, there could be sudden price movements immediately after the auction results are announced. Keeping in view the same, on auction days, the price bands at the start of the day would be fixed at 1 per cent and 1.25 per cent respectively over FIMMDA's closing prices of the previous day. However, the market participants are permitted to place their bids/offers beyond these bands in the auctions.

As soon as the auction results are announced, the price bands would apply on the auction cut-off prices for the rest of the trading day, depending upon the price-band category of the security auctioned.

In case of extra-ordinary circumstances warranting a wider price band/range, the "price band" may be relaxed in consultation with RBI.

In case of a genuine mistake resulting in breaching the price-band for the day, both the buyer and seller should inform FIMMDA of the mistake committed in breaching the price-band.

The Head of Treasury should be responsible for the internal discipline of ensuring that the internal filter is not breached under normal circumstances.

Violation of Code of Conduct:

As any violation of Code of Conduct would be viewed seriously, it is expected that all users will strictly adhere to the Code of Conduct in letter and spirit.

The above code of conduct is mutatis mutandis (with the necessary modifications) applicable to all transactions done and reported on PDO-NDS.