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Going The Extra Mile

SEBI'S STEPS TO SAFEGUARD CLIENTS' FUNDS LYING WITH STOCK BROKERS (SB) AND CLEARING MEMBERS (CM)

SEBI, the regulatory authority overseeing India's securities market, has recently unveiled a groundbreaking circular that has far-reaching implications for Stock Brokers (SB) and Clearing Members (CM). This circular released in the month of June to August 2023, mandates these entities to redirect their clients' funds upstream to Clearing Corporations (CC), heralding a paradigm shift in the management of funds within the securities market.

SEBI's initiative reflects a concerted effort to bolster the security of clients' funds and simultaneously enhance operational efficiency across the market. This article seeks to delve into the multifaceted implications and guidelines inherent in the circular, shedding light on the pivotal role this regulatory action plays in reshaping the security market landscape.

The crux of the circular revolves around a novel framework dictating that SBs and CMs expedite the transfer of all received client funds to CCs. This represents a departure from the traditional practice of retaining clients' funds by these intermediaries at the close of each business day. The circular underscores the imperative of seamless and swift fund movement to clearing corporations.

The circular presents three primary methods through which the transfer of funds should occur:

Cash

The straightforward mode of transferring funds, ensuring immediate liquidity while complying with the circular's directives.

Lien on Fixed Deposit Receipts (FDRs)

- FDRs only with those banks which satisfy the CC's exposure norms as specified by SEBI or CCs from time to time.
- FDR shall necessarily be lien-marked to one of the CCs at all times.
- The tenure of such FDRs shall not be more than one year and one day. Further, the FDR should be pre-terminable on demand.
- Existing FDRs (created out of clients' funds and having tenor of more than one-year) created prior to issuance of the circular shall be allowed to be grandfathered till maturity. Such FDRs at the time of renewal shall meet the conditions specified above.
- The principal amount of the FDR shall remain protected throughout the tenure, even after accounting for all possible pre-termination costs.

- SBs/CMs shall not avail any funded or non-funded banking facilities based on FDRs created out of clients' funds.

Pledge of units from Mutual Fund Overnight Schemes (MFOS):

- MFOS that deploy funds into risk-free government bond overnight repo markets and overnight Tri-party Repo Dealing and Settlement (TREPS).
- Such MFOS units should be in dematerialized (demat) form, and must necessarily be pledged with a CC at all times.
- SBs/CMs shall maintain a dedicated demat account ("Client Nodal MFOS Account") for subscription/ redemption of MFOS units.

Further Is it also mandated to wind up the existing bank guarantees (BGs) created out of client funds by September 30, 2023.

One of the pivotal aspects introduced in the circular is the stringent oversight of the inflow and outflow of funds by stock brokers and clearing members from their constituents. This mandates the establishment of dedicated bank accounts for the purpose of upstreaming and down streaming funds, thereby ensuring a clear demarcation and transparency in transactions. The nomenclature of bank accounts shall be changed to either of the following two categories:

Up Streaming Client Nodal Bank Account (USCNBA): SB/CM shall receive clients' funds in USCNBA for further upstreaming it to the CCs. The nomenclature for such accounts shall be "Name of the SB/CM – USCNB account".

Funds received on a given day by SBs shall be transferred to CMs, and by CMs to the CC any time during the day, Subject to the respective cutoff times mentioned in the circular.

Down streaming Client Nodal Bank Account (DSCNBA): Payment to clients should be done only from DSCNBA account post receiving of funds from CC/CM same day and any balance left in the account post cutoff time should be transferred to USCNBA for further upstreaming it to the CCs. The nomenclature for such accounts shall be "Name of the SB/CM – DSCNB account".

Further, The SBs/CMs may seek withdrawal of client funds from CCs only under specific scenarios and places a responsibility on SBs/CMs to provide reconciliation statements of above as may be required by stock exchanges and CCs.

Exchange has introduced a penalty structure based on escalation for repetitive violation for non-compliance of the following provisions of the aforementioned circulars.

- Clients' funds not transferred to CS's (received before cut-off time)
- Transfer of funds to client from other than DSCNB account
- Receipt of funds from client in other than USCNB account
- Non permissible transfer of funds between USCNB, DSCNB and any other bank account of the member
- Funds lying in bank account are not for legitimate purpose.

In tandem with this, the circular underscores the pivotal role that stock exchanges and CCs play in enforcing compliance by creating SOP for monitoring the implementation of the provisions and may include more compliances clauses in the penalty structure.
In conclusion, SEBI's have taken steps to safeguard clients' funds placed with SBs/CMs and ensure orderly functioning of the securities market by having greater transparency, security, and effectiveness.

Ketan Kini
Associate Director - Risk Advisory
ASA