

CIRCULAR

CIR/HO/MIRSD/DOP/CIR/P/2019/75

June 20, 2019

To

All Recognized Stock Exchanges

All Recognized Clearing Corporations

All Depositories

All Trading Members/Clearing Members through Stock Exchanges/Clearing Corporations

All Depository Participants through Depositories

Madam / Sir,

Sub: Handling of Clients' Securities by Trading Members/Clearing Members

1. In order to protect clients' funds and securities, The Securities Contracts (Regulation) Act, 1956 and Securities and Exchange Board of India (Stock-Brokers) Regulations, 1992 specifies that the stock broker shall segregate securities or moneys of the client or clients or shall not use the securities or moneys of a client or clients for self or for any other client.
2. Further, the following circulars were issued by SEBI from time to time detailing the operational modalities with respect to handling of client's funds and securities by stock broker (hereinafter referred to as 'Trading Member /Clearing Member' or TM/CM):

a) Circular No. SMD/SED/CIR/93/23321 dated November 18, 1993:

In terms of clause 2 of the circular SEBI had inter alia specified that "*it shall be compulsory for all member brokers to keep separate accounts for client's securities and to keep such books of accounts, as may be necessary, to distinguish such securities from his/their own securities. Such accounts for client's securities shall, inter-alia provide for the following:-*

- i. *Securities fully paid for, pending delivery to clients;*
- ii. *Fully paid for client's securities registered in the name of Member, if any, towards margin requirements etc.*

b) SEBI Circular No. MRD/DOP/SE/Cir – 11/2008 dated April 17, 2008:

In the said circular, SEBI had inter-alia specified that '*brokers should have adequate systems and procedures in place to ensure that client collateral is not*

used for any purposes other than meeting the respective client's margin requirements / pay-ins. Brokers should also maintain records to ensure proper audit trail of use of client collateral.

- c) Circular no. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016 and Circular no. CIR/HO/MIRSD/MIRSD2/CIR/P/2017/64 dated June 22, 2017:

In the said circulars, SEBI had specified that "stock brokers shall not grant further exposure to the clients when debit balances arise out of client's failure to pay the required amount and such debit balances continues beyond fifth trading day, as reckoned from the date of pay-in, except in accordance with the margin trading facility provided vide SEBI circular CIR/MRD/DP/54/2017 dated June 13, 2017 or as may be issued from time to time"

- d) Circular No. SEBI/HO/MRD/DP/CIR/P/2016/13 dated December 16, 2016:

In the said circular, SEBI had specified that "the member shall transfer securities from pool account to the respective beneficiary account of their client within 1 working day after the pay-out day. The securities lying in the pool account beyond the stipulated 1 working day shall attract a penalty at the rate of 6 basis point per week on the value of securities."

Therefore, in terms of the above provisions, all TM/CM are required to transfer the clients securities received in pay-out to clients demat account within one working day. In case the client does not pay for such securities received in pay-out, then the TM/CM shall be entitled to retain those securities up to five trading days after pay-out. Further, where the client fails to meet its funds pay-in obligation within five trading days from pay-out day, the TM/CM shall liquidate the securities in the market to recover its dues. Under no circumstances, shall the securities of the clients received in pay-out be retained by the TM/CM beyond five trading days and be used for any other purpose.

3. As per the provisions of the following circulars, TM/CM are permitted to provide running account for securities and create a lien on the client securities to the extent of the clients' indebtedness to the TM/CM.

- a) As per clause 12 of the SEBI circular on 'Dealings between a client and a Stock Broker' dated December 03, 2009 a client may specifically authorize the stock broker to maintain a running account of 'funds' and 'securities' subject to the specified conditions.
- b) As per clause 2.5 of SEBI circular on 'Enhanced Supervision of Stock Brokers/ Depository Participants' dated September 26, 2016 read with clause 2 (c) of SEBI circular CIR/HO/MIRSD/MIRSD2/CIR/P/2017/64 dated June 22, 2017, "a stock broker is entitled to have a lien on client's securities to the extent of the client's indebtedness to the stock broker and the stock broker may pledge those securities."

Referencing the above stated provisions, the TM/CM are transferring client's securities into their own account by way of title transfer and then placing such securities as a collateral to Banks/NBFCs and/or fulfilling securities shortages of other clients/proprietary trades which is not contemplated in the provisions of the SEBI circulars referred to in paragraph 2.

4. In order to provide clarity with respect to a TM/CM maintaining a running account for client securities and pledging the client securities with Banks/NBFCs, after discussions with the Exchanges, Depositories and Clearing Corporations, the following advice is issued:-

4.1 The securities received in pay-out against which payment has been made by clients, shall be transferred to the demat account of the respective clients within one working day of the pay-out. Such securities shall be transferred directly from the pool account of the TM/CM to the demat account of the respective client.

4.2 With regard to securities that have not been paid for in full by the clients (unpaid securities), a separate client account titled – “client unpaid securities account” shall be opened by the TM/CM. Unpaid securities shall be transferred to such “client unpaid securities account” from the pool account of the concerned TM/CM.

4.3 The securities kept in the ‘client unpaid securities account’ shall either be transferred to the demat account of the respective client upon fulfilment of client's funds obligation or shall be disposed off in the market by TM/CM within five trading days after the pay-out. The unpaid securities shall be sold from the Unique Client Code (UCC) of the respective client. Profit/loss on the sale transaction of the unpaid securities, if any, shall be transferred to/adjusted from the respective client account.

4.4 In case the clients' securities are kept in the ‘client unpaid securities account’ beyond seven trading days after the pay-out, the depositories shall under their bye-laws levy appropriate penalties upon such TM/CM which shall not be permitted to be recovered from the client.

4.5 SEBI circular (on Comprehensive Review of Margin Trading Facility) dated June 13, 2017 specifies that TM/CM shall maintain separate client wise ledger for funds and securities of clients availing margin trading facility. Accordingly, the securities that are bought under Margin Trading Facility, shall be kept in a separate account titled as – ‘Client Margin Trading Securities Account’.

4.6 Further said circular on Comprehensive Review of Margin Trading Facility also specifies that:

- a) *For the purpose of providing the margin trading facility, a stock broker may use own funds or borrow funds from scheduled commercial banks and/or NBFCs regulated by RBI. A stock broker shall not be permitted to borrow funds from any other source.*

- b) *The stock broker shall not use the funds of any client for providing the margin trading facility to another client, even if the same is authorized by the first client.*

Also, SEBI vide Circular No. MRD/DOP/SE/Cir – 11/2008 dated April 17, 2008 had specified that client collateral/securities shall not be used for the purposes other than meeting client's margin requirements/pay-in.

Referencing the above stated provisions, TMs/CMs are pledging collateral/securities of the clients with the Banks/NBFCs to borrow funds to meet the margin requirement of the clients/proprietary obligation which is not contemplated in the provisions of the aforesaid SEBI circular. In this regard, it is reiterated that the client securities received as collateral shall be used only for meeting the respective client's margin requirement by way of depositing the same with Stock Exchange/ Clearing Corporation/ Clearing House.

4.7 With effect from September 01, 2019, clients' securities lying with the TM/CM in "client collateral account", "Client Margin Trading Securities account" and "client unpaid securities account" cannot be pledged to the Banks/NBFCs for raising funds, even with authorization by client as the same would amount to fund based activity by TM/CM which is in contravention of Rule 8(1)(f) & 8(3)(f) of Securities Contracts (Regulation) Rules, 1957.

4.8 Further, the client's securities already pledged in terms of clause 2.5 of SEBI Circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016 and clause 2 (c) of SEBI circular CIR/HO/MIRSD/MIRSD2/CIR/P/2017/64 dated June 22, 2017 shall, by August 31, 2019, either be unpledged and returned to the clients upon fulfilment of pay-in obligation or disposed off after giving notice of 5 days to the client.

4.9 Accordingly, the clause 2.5 of SEBI Circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016 and clause 2 (c) of SEBI circular CIR/HO/MIRSD/MIRSD2/CIR/P/2017/64 dated June 22, 2017 stands deleted with effect from June 30, 2019.

5. Opening and reporting of Demat Accounts by TM/CM:

In order to implement the above, the following course of action shall be taken by TM/CM:

- a) All the existing client securities accounts opened by the TM/CM other than 'Pool account' (including 'Early Pay-in'), 'Client Margin Trading Securities account' and 'Client collateral account' shall be wound up on or before August 31, 2019. The TM/CM shall within one week of closure of existing client accounts, inform the Stock Exchange/s the details in the following format:

Name of DP	Account Number/ Client ID	DP ID	Name of Account	PAN	Date of Closing

- b) TM/CM shall open the unpaid securities account latest by August 31, 2019 and inform the details of the same to the respective Stock Exchanges / Clearing Corporations within one week of opening of the unpaid securities account in the following format:

Name of DP	Account Number/ Client ID	DP ID	Name of Account	PAN	Date of Opening

- c) Any non-compliance/non reporting in this regard by the TM/CM shall attract penal action as per the bye-laws of Stock Exchanges.

6. Monitoring with respect to handling of clients securities:

Stock Exchanges, Clearing Corporations and Depositories shall put in place a mechanism for monitoring of the following:

- a) Handling of unpaid clients' securities by the TM/CM – Mechanism of matching of transfer of securities with the securities obligation as obtained from the clearing corporation with respect to the following:
- i. Securities transferred from the client unpaid securities account to the pool account
 - ii. Securities transferred from the client unpaid securities account to the concerned client account,
 - iii. Securities transferred from pool account to the concerned client account
- b) All the DP accounts tagged as “Stock Broker – Client Account” are wound up before August 31, 2019.
- c) Securities lying with TM/CM in client collateral account, client margin trading securities account and client unpaid securities account shall not be permitted to be pledged/transferred to Banks/NBFCs for raising funds by TM/CM.

7. Accordingly, the provisions with regard to running account settlement of clients' funds and securities specified in SEBI Circulars MIRSD/ SE /Cir-19/2009 dated December 03, 2009 and SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016 shall stand modified to the extent as stated hereinabove and the said circulars shall be applicable only as guidelines for running account settlement of clients' “funds” only.

8. Unless otherwise specified in the circular the provisions of this circular shall come into effect on September 01, 2019. Any non-compliance of the provisions issued under this

circular shall attract the penalty and other enforcement action as may be laid down by Exchanges, Clearing Corporations, Depositories and SEBI.

9. The Stock Exchanges, Clearing Corporations and Depositories are advised to:
 - a. Bring the provisions of this circular to the notice of all TM/CM, Depository Participants along with illustration as required and also disseminate the same on their respective websites.
 - b. Make necessary amendments to the relevant bye-laws, rules and regulations for the implementation of this circular in co-ordination with one another to achieve uniformity in approach.
 - c. communicate to SEBI, the status of the implementation of the provisions of this circular in their Monthly Development Reports.
10. This circular is being issued in exercise of powers conferred under Section 11 (1) of the Securities and Exchange Board of India Act, 1992 to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.
11. This circular is available on SEBI website at www.sebi.gov.in under the categories "Legal Framework".

Yours faithfully,

Rajesh Kumar Dangeti
General Manager