

## SECURITIES AND EXCHANGE BOARD OF INDIA

### Amendment to Securities and Exchange Board of India (Stock Brokers) Regulations, 1992 and SEBI (Depositories and Participants) Regulations, 2018 to provide for revised Networth requirement for Trading Members (TMs), Self-Clearing Members (SCMs), Clearing Members (CMs), Professional Clearing Members (PCMs), Depository Participants (DPs) and Deposit & Fees requirement for members in Electronic Gold Receipt (EGR) segment

#### 1. Objective

1.1. This memorandum seeks the approval of the Board to amend the Securities and Exchange Board of India (Stock Brokers) Regulations, 1992 and SEBI (Depositories and Participants) Regulations, 2018 to provide for revised Networth requirement for Trading Members (TMs), Self-Clearing Members (SCMs), Clearing Members (CMs), Professional Clearing Members (PCMs), Depository Participants (DPs) and to provide for deposit and fees requirement for the members in Electronic Gold Receipt (EGR) segment.

#### 2. Background

##### **Existing provisions w.r.t. Stock Brokers in SEBI (Stock Brokers) Regulations, 1992**

2.1. Schedule VI of the SEBI (Stock Brokers) Regulations, 1992, specifies the networth requirement (in Rs.) for Stock Broker / TM, CM and SCM in cash, equity derivatives, currency derivatives and debt segment as under:

<b>Segment</b>	<b>Stock Broker</b>	<b>Clearing Member</b>	<b>Self-Clearing Member</b>
<b>Cash</b>	*	*	*
<b>Equity Derivatives</b>	*	3 crore	1 crore

<b>Currency Derivatives</b>	1 crore	10 crore	5 crore
<b>Debt</b>	50 lakh	3 crore	1 crore

\*As specified by Board from time to time

2.2. Schedule VI of the SEBI (Stock Brokers) Regulations, 1992, specifies the networth requirement (in Rs.) for members dealing in commodity derivatives segment as under:

<b>Type of member</b>	<b>For the members of</b>	
	<b>National Commodity Derivatives Exchanges</b>	<b>Regional Commodity Derivatives Exchanges</b>
<b>Stock Broker / Trading Member</b>	Nil	Nil
<b>Self-Clearing Member</b>	1 crore	*
<b>Clearing Member</b>	3 crore	*

\*As specified by Board from time to time

2.3. The net worth for TM / CM can be specified by the Board from time to time. However, no net worth requirement has been specified for TM, CM and SCM in cash segment. Net worth has also not been specified for TM in equity derivatives and commodity derivatives segment in the SEBI Regulations. This has been left to the Stock Exchanges to specify.

2.4. Stock Exchanges have specified net worth for membership in various segments. Different Stock Exchanges have different minimum net worth requirement for their trading members for each segment. The net worth / range of the net worth requirement for various types of membership in different segments prescribed by the Stock Exchanges are as under:

Segment	Membership type			
	TM	SCM	CM	PCM
	Net worth (Rs. crore)			
Cash	0.25 - 0.75	1	3	3
Equity Derivatives	0.25 - 1	1	3	3
Currency Derivatives	1	5	10	10
Commodity Derivatives	0.10 - 0.50	1	3	5
Debt	0.50	1	3	3

**Existing provisions w.r.t. Depository Participants in SEBI (Depository and Participants) Regulations, 2018**

2.5. The existing networth requirement for stock broker depository participant (SBDP) is Rs. 50 lakhs and aggregate value of portfolio of securities (AVPS) of the BOs held in dematerialized form in a Depository through the entity shall not exceed 100 times of the networth. The SBDP has to comply with networth requirements separately for each depository. Where the networth is more than Rs. 10 crores, the limit on AVPS is not applicable.

**Explanation of Networth in SEBI (Stock Brokers) Regulations, 1992**

2.6. Schedule VI of the SEBI (Stock Brokers) Regulations, 1992 explains the meaning of networth as under:

For the purposes of this Schedule, 'networth' shall mean paid up capital, free reserves and other securities approved by the Board from time to time but shall not include fixed assets, pledged securities, value of member's card, non-allowable securities (unlisted securities), bad deliveries, doubtful debts and advances (debts or advances overdue for more than three months or debts or advances given to the associate persons of the member), prepaid expenses, losses, intangible assets and 30% value of marketable securities.

## **Reasons for revisiting Network requirements**

- 2.7. The network requirement for members in equity derivatives segment was specified in June 1998 and for currency derivatives segment in August 2008. For self-clearing members, network requirement was specified in May 2011. For debt segment, the same was specified in April 2013, while for commodity derivatives segment, it was specified in September 2015.
- 2.8. Further, the securities market witnessed a number of defaults by some stock brokers in which funds and securities of clients were misutilised by them. To protect the interest of investors from such fraudulent stock brokers, SEBI Committees viz. Risk Management Review Committee (RMRC) and Secondary Market Advisory Committee (SMAC) suggested that the network requirement of TM / CM needs a relook and may be increased. It was stressed that margins should be considered as the first line of defence and network as second line of defence. It was suggested that the second line of defence should be strengthened by increasing network requirement for TM / CM. The balance sheet network of the stock broker should be monitored and it should be commensurate with the operational risk being taken by the stock broker with respect to its clients.
- 2.9. In its recent meeting dated November 26, 2020, SMAC further stressed that world over the Clearing Corporations (CCs) do not run only on margins. When the margin fails, the CCs would look at the network of the CM and CM in turn would look at the network of the TM. It has been learnt from the global experiences that it is not possible to bring down the risk only with the margins and a lot of capital is needed to cover the risk that is not covered by margins. There should be further risk coverage beyond margins in the form of network. It was suggested that in addition to a static network, a dynamic capital adequacy norm is also required and the exposure of a TM should be linked to the network. It was also decided that the formula at which the network is calculated, also needs a relook.

- 2.10. Various meetings were held with Market Infrastructure Institutions (MIIs) and it was discussed that existing networth requirements are very miniscule compared to the business that TMs are undertaking and the number of clients that they have. SEBI now grants a single registration and thereafter, segment-wise/exchange-wise permission is granted for trading in respective segment/exchange. Therefore, one base networth of the member makes it eligible for registration and for taking membership on other segments/exchanges.
- 2.11. On the issue of linking networth with AVPS, it was deliberated with MIIs that the role of a DP has reduced considerably with the introduction of pledge- repledge mechanism, restricted use of Power of Attorney (PoA) and block mechanism in case of sale transactions, which are executed through the systems of Depositories and Clearing Corporations. Linking the networth and the custody value of securities may not be relevant because DPs have now limited role in handling client's securities and only act as a facilitator. All the transactions are recorded in books of Depositories.
- 2.12. However, in the SMAC meeting held on November 26, 2020, it was decided that the networth requirement of SBDPs also needs a relook, as the same has not been revised for a long time.
- 2.13. Since SMAC had suggested relook on networth requirement of SBDPs, further meetings were held with MIIs, wherein it was discussed that since most of the DPs are brokers who are clearing for their clients, networth requirement of DPs should be equated with what applies for self-clearing members. It was also discussed that since TMs have networth lower than SCM/CM/PCM, TMs may not be allowed to register as DP.

### **3. Public consultation on review of networth of TM / SCM / CM / PCM / DP**

3.1. With this background, a consultation paper was issued on September 27, 2021 inviting public comments on the review of networth of TM / SCM / CM / PCM / DP. Copy of the consultation paper is placed at Annexure I.

3.2. Comments were received from 17 entities, which included 11 Stock Brokers, 1 Depository Participant, 1 Stock Exchange, 1 Clearing Corporation, 1 Brokers Association, 1 DP Association and 1 Commodity Participants Association. Out of 17 comments received, 1 comment was in favour of the proposal and remaining 16 were in the nature of suggestions/seeking query or clarity on the proposal. Analysis of the same along with the comments of SEBI and final recommendations is placed at Annexure II.

### **4. Analysis of Public Comments**

4.1. The public comments centred largely around following issues:

- a) Trading member (TM) with required Networth should be allowed to work as DP.
- b) In case CM deposits client's funds with CC, the same must be excluded from the calculation of 10% capital adequacy. BG/FDR of client deposited with CC should not be counted for the same.
- c) With respect to explanation of Networth, it was suggested that the total value of Shares owned by TM/CM must be reduced from networth and value post haircut pledged to CC, must be added back to networth. This will ensure that a fair price of securities is accounted for networth computation.
- d) Requirement of variable networth should not be made applicable for brokers who are exclusively members of commodity exchanges.
- e) Breach of variable networth requirement should be monitored.

**On the above public comments, comments of SEBI, in seriation, are as follows:**

- a) The matter w.r.t. allowing TM with required Networth to work as DP was discussed with Depositories again. It was agreed upon that TMs with higher networth (equivalent to that of SCMs), may be allowed to register as DP since higher networth requirement will take care of the risk carried by DPs.
- b) In case CM deposits client's funds with CC, the same shall be excluded from the calculation of 10% capital adequacy. Cash/FDR accepted by members shall be included in 10% of average cash balances. BG/FDR of client deposited with CC shall not be counted for the same.
- c) The total value of Shares owned by TM/CM must be reduced from networth and value post haircut pledged to CC must be added back to networth. This will ensure a fair price of securities is accounted for networth computation.
- d) Commodity exchange is also a Stock Exchange now and itself is eligible to trade in equity segment. Therefore, it should also follow the same Networth requirement for its members as proposed for Stock Exchanges.
- e) Monitoring of breach of variable networth requirement shall be done by Exchanges by way of reporting requirement on a regular basis. Monitoring of short capital would be done on monthly basis by Exchanges and member shall submit its half-yearly accounts, which shall reflect the networth on 30th September and 31st March. Members shall be required to increase its networth in case of shortfall, as specified by SEBI / Exchanges.

## **5. Proposal**

5.1. In view of the detailed deliberations held with MIIIs and based on the public comments received on the consultation paper, the following is proposed:

- 5.1.1. Networth requirements for members shall be Base Networth or Variable Networth, whichever is higher (tabulated in para 6 below). The variable networth shall be calculated as 10% of average daily cash balance of clients retained with the member across segments/exchanges in the previous 6 months. Cash/FDR accepted by members shall be included in 10% of average cash balances. BG/FDR of client deposited with CC shall not be counted for the same.
- 5.1.2. In case a Trading Member deposits the fund with Clearing Member / Clearing Corporation, then maintenance of variable networth as Trading Member would be reduced to the extent of client's funds deposited with Clearing Member / Clearing Corporation. Where the TM deposits the client funds with CM, the computation of variable networth at the level of CM shall also include the funds of the clients of TM, deposited by TM with the CM. Similarly, in case CM deposits client's funds with CC, the same must be excluded from the calculation of 10% capital adequacy for the CM.
- 5.1.3. Monitoring of breach of variable networth requirement shall be done by Exchanges by way of reporting requirement on a regular basis. Monitoring of short capital would be done on monthly basis by Exchanges and member shall submit its half-yearly accounts, which shall reflect the networth on 30th September and 31st March. Members shall be required to increase its networth in case of shortfall, as specified by SEBI / Exchanges.
- 5.1.4. In case stock broker is willing to act as a depository participant, the networth of DP would be made equivalent to that of SCM (as tabulated in para 6). The aggregate value of portfolio of securities shall not be required to be linked to networth. It is proposed that the existing networth of a SCM shall suffice for it to register as a DP.

5.1.5. The computation of networth shall continue as per the explanation provided in Schedule VI of the SEBI (Stock Brokers) Regulations, 1992. However, following clarifications are proposed:

- a) For share capital, compulsorily & mandatorily convertible debentures / bonds / warrants which are convertible within a period of 5 years from the date of issue, will be considered.
- b) Free reserves shall include Profit & Loss, General Reserve, Securities Premium, Preference Share Redemption Reserve and Capital Redemption Reserve, but will not include reserves created by revaluation of assets.
- c) The total value of Shares pledged by TM/CM to CC must be reduced from networth and value post haircut pledged to CC must be added back to networth. This will ensure that a fair price of securities is accounted for networth computation.
- d) Under the non-allowable asset head of 'Doubtful Debts and advances', 'Any Debts or Advances (except trade debtors of less than 3 months)' shall be non-allowable asset.

### **Proposal regarding capital adequacy criteria and turnover fees for members in proposed Gold Exchange**

5.2. The Hon'ble Finance Minister, in her budget speech, announced that government will notify SEBI as the regulator for Gold Exchange. The same is yet to be notified in the Gazette.

5.3. In the SEBI Board meeting held on September 28, 2021, the board approved the framework for Gold Exchange and SEBI (Vault Managers) Regulations, 2021. These regulations will be notified after EGR is notified as security under Securities Contracts (Regulation) Act, 1956. The framework inter-alia specifies that EGR can be launched by all the exchanges i.e. existing as well as new, and the same should be launched in the new segment.

- 5.4. To operationalize the new segment, the stock exchanges are required to seek approval from SEBI and afterwards, stock brokers/ trading members/ clearing members shall seek registration for the new segment. As per SEBI (Stock Broker) Regulations, 1992, a single registration is granted by SEBI to a new member and thereafter, segment-wise /exchange-wise permission is granted by the Stock Exchange or Clearing Corporation.
- 5.5. As EGRs will be launched in a new segment, net-worth, deposit and fees requirement to be maintained by the members have to be prescribed. Since the proposed networth requirements will suffice across all the segments / exchanges, it is proposed that there is no need to specify networth separately for EGRs segment.
- 5.6. Trading of EGR is akin to trading of equity shares in the cash segment on stock exchanges. Thus, it is proposed that similar fee structure as applicable to equity segment may be levied to the stock broker/clearing and self-clearing members of the new EGR segment. Since EGR will be a highly valued security because of the value of the underlying i.e. gold, it is proposed that the deposit requirement for EGR segment may be kept at minimum of ₹1 crore for CM and SCM. The deposit requirement for Stock Broker may be kept same as in other segments.
- 5.7. Based on the inputs received from MIIs, market participants and others, following proposal is put up for consideration of the Board:
- 5.7.1. Schedule VI of the SEBI (Stock Brokers) Regulations, 1992 may be amended
- 5.7.1.1. to incorporate the revised networth requirement for TM, CM, SCM and PCM;
  - 5.7.1.2. to incorporate proposed clarifications to 'explanation' of networth; and
  - 5.7.1.3. to incorporate deposit requirement w.r.t. EGR segment

5.7.2. Schedule V of the SEBI (Stock Brokers) Regulations, 1992 may be amended to incorporate fees requirement for EGR segment.

5.7.3. Point (viii) of Regulation 35 of Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018 may be amended to provide for revised networth requirement for stock broker who seeks to act as a depository participant.

## **6. Proposed Amendments to SEBI (Stock Brokers) Regulations, 1992 and SEBI (Depository and Participants) Regulations, 2018**

6.1. As proposed above, to incorporate the revised networth requirement for Trading Member, Clearing Member, Self-Clearing Member and Professional Clearing Member and to include proposed clarifications to explanation of networth, Schedule VI of the Securities and Exchange Board of India (Stock Brokers) Regulations, 1992, may be amended as follows:

6.1.1. Point no. 1, 3 and 5 of Schedule VI shall be replaced as under:

**Point no. 1:** The stock broker shall have a net-worth and shall deposit with the stock exchange a sum as may be specified by the Board/Stock Exchange from time to time.

**Point no. 3:** The quantum of networth and deposit to be maintained by the trading member/ clearing member / self-clearing member / professional clearing member, dealing/clearing and settling trades in securities including commodity derivatives, shall be as specified in Table 1 and Table 2 of this Schedule.

**Point no. 5:** If a member satisfies the networth requirement in any one of the Stock Exchanges in any segment, then that will satisfy the networth requirement for other segment / Stock Exchange(s) also.

6.1.2. Point no. 6 shall be added to Schedule VI as under:

**Point no. 6:** In case a Trading Member deposits the fund with Clearing Member / Clearing Corporation, then maintenance of

variable networth as Trading Member, would not be required to the extent of client's funds deposited with Clearing Member / Clearing Corporation. Where the Trading Member deposits the client funds with Clearing Member, the computation of variable networth at the level of Clearing Member shall also include the funds of the clients of Trading Member, deposited by Trading Member with the Clearing Member. Similarly, in case Clearing Member deposits client's funds with Clearing Corporation, the same must be excluded from the calculation of 10% capital adequacy. Cash / Fixed Deposit Receipts accepted by members shall be included in 10% of average cash balances. Bank Guarantee / Fixed Deposit Receipts of client deposited with Clearing Corporation shall not be counted for the same.

6.1.3. Table 1 and Table 2 of Schedule VI shall be replaced as follows:

**TABLE 1**

**NETWORTH FOR MEMBERS DEALING IN SECURITIES**

<b>Type of Member</b>	<b>Base Networth (within 1 year of the regulations being notified) (in Rs.)</b>	<b>Base Networth (within 2 years of the regulations being notified) (in Rs.)</b>	<b>Variable Networth (within 1 year of the regulations being notified) #</b>
<b>Trading Member</b>	-	1 crore	10% of average daily cash balance of clients retained with the member across segments/exchanges
<b>Self-Clearing Member</b>	3 crore*	5 crore	

<b>Clearing Member</b>	10 crore*	15 crore	in the previous 6 months.
<b>Professional Clearing Member</b>	25 crore	50 crore	

\*The existing requirement of minimum networth of Rs. 5 crores and Rs. 10 crores in currency derivatives segment for Self-Clearing Member and Clearing Member respectively, shall remain applicable.

# Networth requirement for members shall be Base Networth or Variable Networth, whichever is higher.

**TABLE 2**  
**DEPOSIT FOR MEMBERS DEALING IN SECURITIES**

<b>Segment</b>		<b>Trading member (in Rs.)</b>	<b>Clearing member (in Rs.)</b>	<b>Self-clearing member (in Rs.)</b>
<b>Cash</b>		*	*	*
<b>Equity Derivatives</b>		*	50 Lakh	50 Lakh
<b>Currency Derivatives</b>		*	50 Lakh	50 Lakh
<b>Debt</b>		*	*	*
<b>Commodity Derivatives</b>	<b>NCDE</b>	Nil	50 Lakh	50 Lakh
	<b>RCDE</b>	Nil	*	*
<b>Electronic Gold Receipts</b>		*	1 crore	1 crore

NCDE: National Commodity Derivatives Exchanges

RCDE: Regional Commodity Derivatives Exchanges

\*As may be specified by the Board from time to time

6.1.4. Explanation shall be replaced as follows:

Explanation:

For the purposes of this Schedule, 'base networth' shall mean paid up capital; fully, compulsorily & mandatorily convertible debentures / bonds / warrants which are convertible within a period of 5 years from the date of issue, free reserves (shall include Profit & Loss, General Reserve, Securities Premium, Preference Share Redemption Reserve and Capital Redemption Reserve, but shall not include reserves created by revaluation of assets) and other securities approved by the Board from time to time but shall not include fixed assets, pledged securities, value of member's card, non-allowable securities (unlisted securities), bad deliveries, any debts and advances (except trade debtors of less than 3 months), prepaid expenses, losses, intangible assets and 30% value of marketable securities:

Provided in case of securities pledged to clearing corporation, post haircut value of shares owned by Trading Member / Clearing Member, shall be considered for computation of the networth.

Provided that the deposit requirement specified for the debt segment shall not be applicable when a clearing member clears and settles all the trades only on gross basis for both securities and funds, without using settlement or trade guarantee fund:

Provided further that where the stock broker, clearing member or self-clearing member in the debt segment, is also regulated by a sectoral regulator other than the Board, the networth shall be computed in the manner as specified by such sectoral regulators.

6.2. The definition of Professional Clearing Member may also be inserted as Regulation 2(1)(ca) of the Securities and Exchange Board of India (Stock Brokers) Regulations, 1992, as under:

“professional clearing member” means a member having clearing and settlement rights in any recognized clearing corporation, but not having trading rights in any recognized stock exchange.

Accordingly, Existing Regulation 2(1)(ca) may be replaced as 2(1)(cb).

6.3. As proposed above, to provide for revised networth requirement for stock broker who seeks to act as a depository participant, Regulation 35 (viii) of Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018 may be amended as follows:

6.3.1. a stock broker who has been granted a certificate of registration by the Board under sub-section (1) of section 12 of the Act:

Provided the stock broker shall have a networth of rupees three crores (within one year of the regulations being notified), which shall be increased to rupees five crores (within two years of the regulations being notified):

Provided further that the existing networth of a self-clearing member shall suffice for it to register as a Depository Participant.

6.4. As proposed above, to provide for fees requirement for stock brokers in Electronic Gold Receipt segment, Schedule V of the Securities and Exchange Board of India (Stock Brokers) Regulations, 1992, may be amended as follows:

6.4.1. Point 1B may be inserted in Part A of Schedule V as under:

This schedule shall apply to every stock broker who deals in electronic gold receipt segment and every clearing member / self-clearing member who clears and settles trades in electronic gold receipt segment, from the date of grant of registration.

6.4.2. One row may be inserted to the Table in Part B of Schedule V, as under:

Segment	Rate/Amount (in Rs.)			Remarks
	Stock broker	Clearing member	Self-clearing member	
<b>Electronic Gold Receipt Segment</b>	0.00010 percent of turnover (Rs. 10 per crore)	*	*	All sale and purchase transactions in EGR.

## 7. Proposal for consideration and approval

7.1. The Board is requested to consider and approve the proposed amendments to Securities and Exchange Board of India (Stock Brokers) Regulations, 1992 and Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018, as mentioned in Para 6 above. The proposed amendments in point no. 6.1.3 w.r.t. Deposit requirement for members in EGR segment and point no. 6.4 w.r.t. Fees requirement for members in EGR segment, may be incorporated after Gold Exchange gets notified by the Central Government. The Board is also required to authorize the Chairman to carry out any consequential, incidental and necessary modifications in the Regulations as he may deem appropriate, to give effect to the decision.

## **Annexure I**

Consultation Paper is available at [www.sebi.gov.in](http://www.sebi.gov.in).

## **Annexure II**

This has been excised.