

SECURITIES AND EXCHANGE BOARD OF INDIA

Memorandum to the Board

Budget Announcement regarding integration of brokers in Equity Markets and Commodity Derivative Markets

Objective

Integration of broking activities in Equity Markets and Commodity Derivative Markets under single entity.

1.0 Background

1.1 Hon'ble Minister of Finance, Government of India, in his speech while presenting the Budget for FY 2017-18 on February 01, 2017, announced that the commodities and securities derivative markets will be further integrated by integrating the participants, brokers, and operational frameworks.

2.0 Current Scenario in Registration of Stock Brokers / Clearing Members dealing in Commodity Derivatives and Equity/ Equity Derivatives :

2.1 Pursuant to the merger of Forward Market Commission's (FMC) with Securities and Exchange Board of India (SEBI), the supervision and regulation of commodity derivatives brokers has been vested with SEBI. Accordingly, amendments were made to SEBI (Stock Brokers and Sub-brokers) Regulations, 1992 (Stock Broker Regulations) to provide for the regulation and the supervision of brokers dealing in commodity derivatives as stock brokers. SEBI also clarified by issuing a circular that all existing members of commodity derivatives exchanges were required to meet the eligibility criteria as specified under Rule 8 of Securities Contract (Regulation) Rules, 1957 (SCRR) and Stock Broker Regulations, within a period of one year from the merger of FMC with SEBI i.e., by September 28, 2016.

2.2 Rule 8(1)(f) and Rule 8(3)(f) of the SCRR disqualifies the persons, engaged as principal or employee in any business other than that of securities or commodity derivatives except as a broker or agent not involving any personal financial liability, to

be elected as a member of a Stock Exchange. To facilitate continuity in activities of brokers dealing in commodity derivatives, it was further clarified that, “business in goods related to the underlying” and/ or “business in connection with or incidental to or consequential to trades in commodity derivatives” by a member of a commodity derivatives exchange, would not be disqualified under Rule 8(1) (f) and Rule 8(3)(f) of the SCRR .

2.3 SEBI, in the year 2014, eased the operational requirements for registration as a stock broker and clearing member and allowed single registration process for stock brokers and clearing members that allows them to operate across stock exchanges / clearing corporations, without the requirement of coming back to SEBI. The single registration procedure is also made applicable for stock brokers operating in commodity derivatives.

3.0 Examination of the proposal

3.1 The first proviso to Rule 8 (1) (f) of SCRR states as follows:

"no member may conduct business in commodity derivatives, except by setting up of a separate company which shall comply with the regulatory requirements, such as, net worth, capital adequacy, margins and exposure norms as may be specified by the Forward Market Commission, from time to time".

3.2 Regulation 18C Stock Brokers Regulations states as follows:

18C. (1) *A stock broker carrying on the activity of buying, selling or dealing in securities, other than commodity derivatives, shall not undertake the activity of buying, selling or dealing in commodity derivatives, unless permitted by the Board.*

(2) *A stock broker carrying on the activity of buying, selling or dealing in commodity derivatives, shall not undertake the activity of buying, selling or*

dealing in securities other than commodity derivatives, unless permitted by the Board."

3.3 Thus, currently, as per aforementioned provisions of SCRR and Stock Broker Regulations, a stock broker / clearing member carrying on the activity of buying, selling or dealing in securities, other than commodity derivatives, cannot undertake the activity of buying, selling or dealing in commodity derivatives, or vice versa except by setting up of a separate entity i.e. at present, a single entity can hold memberships of equity cash, equity derivatives, currency derivatives and debt segments across exchanges, but can hold membership of commodity derivatives exchange by setting up a separate entity.

3.4 The matter of allowing the same entity to act as stock broker / clearing member in the equity and the commodity derivatives markets was taken up during the financial year 2016-17. The issue was discussed in various meetings with the stock exchanges, depositories, stock brokers, depository participants and their associations. The following are the views that emerged during discussions:

- a. Since erstwhile FMC has been merged with SEBI in September 2015 and all the stock exchanges and their members are now under the same regulator i.e. SEBI, it makes a good case for a single entity to be permitted to be a member of all stock exchanges under SEBI.
- b. Consequent to merger of FMC with SEBI, various regulatory provisions in respect of the functioning of the stock brokers across equity / equity derivatives markets and commodity derivatives markets viz., segregation of funds and securities, running account settlement, contract note, KYC, AML, inspections, internal / system audit, investor grievance redressal mechanism, arbitration, maintenance and preservation of records, change in control / constitution, surrender of membership, outsourcing of activities for brokers, authorized persons, etc. have now been harmonized.

- c. In order to increase robustness and to streamline the risk management and margining framework across commodity derivatives exchanges, norms have been issued by SEBI which inter alia prescribe guidelines for margin calculations, margin collection, Base Minimum Capital, acceptable forms of Liquid Asset deposits with appropriate haircuts and concentration limits, etc.
- d. SEBI has over a period of time taken steps by issuing circulars to harmonize the operational, functional, risk management etc. framework between brokers operating in equities and commodity derivatives. Accordingly, the next logical step would be to permit the stock broker / clearing member buying, selling or dealing in securities other than commodity derivatives to buy, sell or deal in commodity derivative without setting up separate entity and vice versa.
- e. Integration of the brokers in equity and commodity derivative markets may benefit the investors, brokers, Stock Exchanges and SEBI as there are many commonalities between the two markets in terms of trading and settlement mechanism, risk management, redressal of investor grievances etc. Integration would also have following benefits:
 - i. A unified entity offering intermediation across asset classes would provide for efficiency of capital use to the investors and thus enhancing the value to the overall financial services ecosystem in Indian securities markets.
 - ii. It will also enhance the economic efficiency in terms of meeting the operational as well as compliance obligations at a Member level resulting in ease of doing business and would result in efficient utilization of the collaterals across asset classes and segments.
 - iii. The said integration would help in widening market penetration leading to greater financial inclusion for participants across all market segments and would facilitate effective regulatory oversight by Stock Exchanges and SEBI.
 - iv. Additionally, a unified entity will have much better risk management capabilities as against separate risk management systems for equity and commodity broking and extend the benefits of economies of scale.

- f. To enable integration of the brokers in equity and commodity derivative markets, deletion of the first proviso to Rule 8 (1) (f) of SCRR and Regulation 18C Stock Brokers Regulations would be required. Further, an intimation may be issued by way of a circular to the market that a single entity can act as stock broker / clearing member in commodity derivative markets as well as in the equity markets.

4.0 Proposal

4.1 In view of the above, it is proposed that Stock Brokers Regulations and SCRR may be amended by deletion of Regulation 18C of the Stock Brokers Regulations and the first proviso to Rule 8 (1) (f) of SCRR to permit a single entity to act as stock broker / clearing member in commodity derivative markets as well as in the equity markets.

4.2 The Board is requested to approve the above proposal and authorize the Chairman to carry out necessary amendments to the SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 with consequential changes, as may be required and to take up the matter of amending Securities Contracts (Regulation) Rules, 1957 with the Government of India.