Sebi plan to introduce capital adequacy norms rattles stockbrokers

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The Securities and Exchange Board of India's (Sebi) plan to introduce capital adequacy norms is causing further heartburn to brokers. Stockbrokers are already grappling with new guidelines around margin pledging, increase in upfront margin for intra-day trading, and strict penalties for violation of these norms.

Sebi Chairman Ajay Tyagi, while addressing a conference recently, stressed the need for bringing new capital adequacy norms. “There are all types of brokers in the system. The net worth requirement was set almost a decade back. So that area needs reform. We will examine this. Capital adequacy should be the first level of consideration,” he said.

Brokers contend that there is no need for capital adequacy norms when Sebi has already reduced brokers’ dependency on client securities and margin. “Sebi has disallowed brokers from funding customers in any manner. If no funding is done, there is no reason for capital adequacy,” said Nitin Kamath, CEO, Zerodha.

Alok Churiwala, MD, Churiwala Securities, said there is no need for capital adequacy when transactions have to be backed by upfront margins. "If we can ensure the safety of investors in a manner where the friction caused on the trade is minimal, that should be the way forward." The thinking within a section of the market is that tightening of the entry barrier higher may help mitigate the rising instances of defaults and unethical practices in the broking industry. Capital adequacy is the minimum capital requirement to be eligible for the business. The term is common in the banking industry where a lender’s capital adequacy is linked to their credit exposure. In the broking industry, Sebi and stock exchanges have set minimum deposits and net worth requirements. These differ from Rs.75 lakh to Rs.10 crore, depending on the nature of the broker, as well as the segment he/she wants to operate in. Brokers further said the current capital adequacy norms are quite stringent for brokers. “The general accounting definition of net worth is capital and free reserves. When brokers take into account net worth, they take into account only liquid assets, that is their cash and liquid assets. Whatever fixed assets are owned, they are all deducted from the net worth for Sebi purposes,” said Churiwala. Some believe brokers in the current form act only as a pass-through providing just a platform for investors to trade. Prescribing capital adequacy, they say, would increase the costs for the industry and, thereby, for investors.

CAPITAL ISSUES

The industry is divided over Sebi's capital adequacy proposal

Net worth (₹ cr)

	TM	TM & SCM	TM & CM	PCM
Cash	0.75	1.00	3.00	3.00
F&O	1.00	1.00	3.00	3.00
Curreny	1.00	5.00	10.00	10.00
Commodity	0.50	1.00	3.00	5.00

Source: NSE; Note: TM = Trading Membership; TM & SCM = Trading and Self Clearing Membership; TM & CM = Trading and Clearing Membership; PCM = Professional Clearing Membership

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Already, many players in the industry are grappling with regulatory changes.

In July 2020, Sebi issued guidelines to curb margin trading. The norms, which become effective from December 2020, require brokers to collect the value at risk (VAR) margin and extreme loss margin (ELM) even for trading in the equity cash segment. From December onwards, brokers will be penalised if margin to clients is more than 25 per cent of the sum of VAR and ELM.

Also with effect from September 1, Sebi has done away with the erstwhile system where brokers could obtain a power of attorney over client securities.

Further, brokers said stringent broking norms could be detrimental to small brokers. “I don’t think net worth should be increased for people entering the business... You are making it tougher for new players to come and disrupt. But as the size of the business grows, the net worth should proportionately increase,” said Kamath.

Moreover, according to brokers, any amount of capital adequacy will not be sufficient when there is a big scam. And perhaps better reporting, surveillance, and proper implementation of the current rules will be more helpful in ensuring investor safety. Brokers agree raising capital adequacy if it weighs against the size of the business will be a fair thing to do as brokers enable futures and options trade even if they are not lending money.

“Every futures and options trade can potentially make you lose more money over what is collected from customers. And if there is a big move in the market, the broker's net worth may get wiped out in a fraction of a second,” said Kamath.

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