As Sebi's peak margin norms kick in, broker default risk should decline now

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The Securities and Exchange Board of India's (Sebi's) mandated peak margin reporting norms have come into force from Tuesday. While the new norms are expected to make the environment safer, intraday traders will need to adapt their strategies.

Until now, the margin was collected on the basis of the end-of-the-day positions. Exchanges would send a file in the evening and brokers would ensure their clients had 100 per cent of the required margin in their accounts for positions carried over to the next day.

Suppose a client held one lot of Nifty futures at the end of, say, Monday. If the margin required was Rs 1.6 lakh, he/she would have had to have this amount in his/her account.

Suppose on Tuesday, he/she buys two more lots. His/her peak position during the day will rise to three lots. At 1 pm, he/she sells the two lots. Under the earlier system, on Tuesday evening, too, his/her margin requirement would be Rs 1.6 lakh.

From December 1, exchanges will take four snapshots of positions at random times during the day. Continuing with the above example, suppose a trader buys two lots of Nifty futures at 9.15 am on Tuesday and sells them at 1 pm. One of the snapshots will capture the fact that he/she held three lots during the day.

Starting Tuesday, the exchanges will report his/her peak margin requirement at Rs 4.8 lakh (Rs 1.6 lakh for the lot purchased on Monday and Rs 3.2 lakh for the two lots purchased on Tuesday). If he/she fails to do so, he/she will have to pay a penalty. This change is being implemented gradually.

Since there were no checks earlier to ensure brokers were collecting sufficient margins intraday, the latter allowed clients to trade with very little margin. High leverage was the carrot they dangled to attract customers. Customers were allowed to hold heavily leveraged positions intraday, with the expressed understanding they would square them off before the end of the day.

The problem arose if the markets fell. Losses would then far exceed the margin amount. In extreme cases, the broker would go bust.

IN A PHASED MANNER

Peak margin requirement that has to be met (%)

Phase 1	Dec 1,'20–Feb 28,'21	25
Phase 2	Mar 1–May 31,'21	50
Phase 3	Jun 1–Aug 31,'21	75
Phase 4	Sep 1,'21 and after	100

Source: Sebi circular dated July 20, 2020

High leverage is a primary reason for traders losing money. "If the level of leverage traders can take reduces, it will restrict their losses," says Nithin Kamath, founder and chief executive officer (CEO), Zerodha.

In the past, when clients who put up very little money carried over their positions, the broker would meet the margin requirement on their behalf. He would pay this amount from his own capital or use the idle balances of other clients.

"Funding the trades of some clients using money belonging to others will end," says Jimeet Modi, founder and CEO, Samco Securities.

The incidence of brokers defaulting is also expected to reduce.

All broking houses will now offer a similar level of leverage.

"Customers will no longer choose a broker on the basis of the amount of leverage offered, which was not advisable," says Shrey Jain, founder, SAS Online, a Delhi-based discount broking firm.

Intraday traders will be unable to acquire large positions with small amounts of capital. "Their cost of trading will rise. They will need to move towards hedged positions, where the profits may be lower, but so will the capital required," says Modi.

Indian exchanges had reduced their margin requirements for hedged positions from June 1.