SEBI seeks to hike net worth requirement for brokers as defaults spike

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The Securities and Exchange Board of India (Sebi) has proposed to increase the net worth requirement for stock brokers manifold, amid a spate of defaults by brokers and several instances of misuse of client securities.

Currently, the net worth requirement for brokers differs for each segment and functions they reform. For instance, a so-called professional clearing member (PCM) or a trading and clearing member (TM & CM) is required to have networth of Rs 3 crore for the cash segment and another Rs 3 crore for the equity derivatives segment.

Sebi has proposed that the base networth for PCM should be increased to Rs 25 crore by October 2022 and further to Rs 50 crore a year later. Some large brokers may even have to show higher net worth if the 10 per cent of the average daily cash balance of their clients they retain exceeds Rs 50 crore or other slabs prescribed by the regulator.

In a discussion paper, Sebi has said the current net worth thresholds were set two decades ago and given the increase in the number of new accounts, there is a need to relook at the parameters.

“The failure of the capital market intermediaries to meet client obligations may arise out of the operational risk, using client money for other client or proprietary trading. The current minimum capital norms do not adequately address these risks,” the regulator has said, inviting public feedback until October 18.

The regulator has said the balance sheet of brokers are be monitored and commensurate with the operational risk they take with respect to its clients.

Industry players said the latest proposals will put further pressure on the brokers, who have been grappling with several regulatory changes.

Some players have questioned the timing of the move.

BASE NET WORTH

Higher base net worth and variable net worth will be considered (₹ cr)

	By October 2022	October 2023 onwards
TM	0	1
TM & SCM	3	5
TM & CM	10	15
PCM	25	50

TM: Trading member — Source: Sebi

VARIABLE NET WORTH

10% of average daily cash balance of clients retained with the member across segments/exchanges in the previous 6 months

"After the introduction of pledge re-pledge norms and barring brokers from accessing client securities, the risks have gone down significantly. Most brokers act as pass-through intermediaries. Higher base capital norms will reduce the number of players in the segment, stifle competition and innovation," said a founder of a small-sized brokerage.

Post the Covid-19 pandemic, the industry has seen record number of first-time investors.

"The significant increase in the number of investors participating in the securities market, it seems appropriate that a review of net worth of the members… it was observed that existing base net worth requirements are very miniscule compared to the business that TMs are undertaking and the number of clients that they have," Sebi has said.

In recent years, Sebi has hiked networth of several other intermediaries. In 2014, it increased the networth requirement for asset management company from Rs. 10 crore to Rs. 50 crore. In 2019, networth of portfolio managers was revised from Rs 2 crore to Rs 5 crore and that of credit rating agencies was also revised from Rs 5 crore to Rs 25 crore.

Sebi has said higher net worth requirements for the broking industry will ensure client safety.

"Handling of funds and securities results in their clients having a credit exposure against them. From the point of view of market safety, it is crucial that the risk of loss of clients' assets in the event of default by the intermediary is mitigated, regardless of such default being on account of own trading or non-trading losses of the intermediary or due to default of another fellow customer," the regulator has said.

Sebi has also proposed to increase the net worth requirement for stockbrokers who act as depository participants, to Rs 5 crore by October 2023 onwards.

The regulator has said the computation of net worth will be based on the recommendations made by the LC Gupta committee.

Resource: Business Standard, 28 September 2021