

DRAFT CIRCULAR FOR PUBLIC COMMENTS

Enhancement of operational efficiency and Risk Reduction - Pay-out of securities directly to client demat account

Background

1. In recent past, SEBI, in a move to protect client's securities and ensure segregation of client's securities, has taken various steps including making Block mechanism for EPI mandatory and Validation of Pay-in Instructions against the respective client's obligations.
2. Currently, the clearing corporation credits the pay-out of securities in the pool account of broker, who then credits the same to the respective client demat accounts. Further, a facility of direct delivery to investor was introduced vide circular SMDRP/Policy/Cir-05/2001 dated February 01, 2001. Now, in a move to enhance operational efficiency and reduce the risk to clients' securities, it has been deliberated to make the process of direct payout of securities to the client account mandatory.

Public Comments:

Draft circular on "Enhancement of operational efficiency and Risk Reduction - Pay-out of securities directly to client demat account" is placed at **Annexure A**. The comments/suggestions should be submitted latest by May 30, 2024, through the following link:

<https://www.sebi.gov.in/sebiweb/publiccommentv2/PublicCommentAction.do?doPublicComments=yes>

In case of any technical issue in submitting your comment through web based public comments form, you may write to consultationMIRSD@sebi.gov.in with the subject: "Public comments on Draft Circular - Enhancement of operational efficiency and Risk Reduction - Pay-out of securities directly to client demat account".

DRAFT CIRCULAR

SEBI/HO/MIRSD/MIRSD-PoD1/P/CIR/2024/XXX

May XX, 2024

To,

All recognized Stock Exchanges and Clearing Corporations

All Depositories

Madam / Sir,

Sub: Enhancement of operational efficiency and Risk Reduction - Pay-out of securities directly to client demat account

1. SEBI, vide Master Circular for Stock Brokers dated May 17, 2023, *inter alia*, specified various processes for handling of clients' securities with regard to pay-in and pay-out of securities. This is to protect clients' securities and to ensure that the stock broker segregates securities of the client or clients so that they are not vulnerable to misuse.
2. The matter related to the funds of the clients has been addressed through upstreaming and downstreaming of funds mechanism. The matter related to flow of securities also needs to be addressed for the payout of securities. Currently, the securities received in payout are pooled by the broker and then credited to the respective client demat accounts.
3. It is to be mentioned that the direct payout to client account was already facilitated on voluntary basis vide circular SMDRP/Policy/Cir-05/2001 dated February 01, 2001. It has been decided that the process of securities payout directly to the client account shall now be mandatory.
4. SEBI had extensive discussions with the Stock Exchanges, Clearing Corporations (CCs) and Depositories. The proposal was also discussed in the meeting of Intermediary Advisory Committee and with Broker's Industry Standards Forum (ISF), which comprise of industry representatives. Accordingly, after extensive deliberations, the following has been decided:

- 4.1. The securities for pay-out shall be credited directly to the respective client's demat account by the CCs.
- 4.2. CCs shall provide a mechanism for Trading Member(TM)/Clearing Members (CM) to identify the unpaid securities and funded stocks under the margin trading facility.
- 4.3. With regard to unpaid securities, the processes as specified at para 45 of SEBI "Master Circular for Stock Brokers" dated May 17, 2023 shall be applicable.
- 4.4. With regard to funded stocks under the margin trading facility, para 41.9 of SEBI "Master Circular for Stock Brokers" dated May 17, 2023, is amended as follows.

"41.9. Funded stocks held by the TM / CM under the margin trading facility shall be held by the TM / CM only by way of pledge. For this purpose, the TM / CM shall be required to open a separate demat account tagged 'Client Securities under Margin Funding Account' in which only funded stocks in respect of margin funding shall be kept/ transferred, and no other transactions shall be permitted. Such funded stocks shall be transferred to respective client's demat account followed by creation of an auto-pledge (i.e., without the requirement of a specific instruction from the client) with suitable reason, in favor of 'Client Securities under Margin Funding Account'."

Handling of shortages arising due to inter se netting of positions between clients:

5. In case of any shortages arising due to inter se netting of positions between clients i.e., internal shortages, the following measures shall be taken to streamline the processes of handling of such shortages across the market:

- 5.1. TM/CM shall handle such shortages through the process of auction as specified by CCs.

5.2. In such cases, the brokers shall not levy any charges on the client over and above the charges levied by the CCs.

Provision not applicable to:

6. The processes specified at para 4 above, shall not be applicable to clients having arrangements with custodians registered with SEBI for clearing and settlement of trades.

Schedule of Implementation:

7. The provisions of this circular shall come into force with effect from DD-MM-YYYY.

8. The implementation standards shall be formulated by the Broker's Industry Standards Forum (on a pilot basis), under the aegis of the stock exchanges and in consultation with SEBI by DD-MM-YYYY.

9. Stock Exchanges, Depositories and CCs are directed to:

9.1. bring the provisions of this circular to the notice of their members / participants and also disseminate the same on their websites;

9.2. put in place appropriate systems and procedures to ensure compliance of the provisions of this circular;

9.3. make necessary amendments to the relevant Bye-laws, Rules and Regulations for the implementation of the above decision;

9.4. communicate to SEBI, the status of the implementation of the provisions of this circular in their Monthly Development Reports.

10. This circular is issued in exercise of powers conferred under Section 11(1) of Chapter IV of the Securities and Exchange Board of India Act, 1992, and Section 19 of Chapter IV of the Depositories Act, 1996 to protect the interests of investors in securities and to promote the development of, and to regulate the securities markets.

11. This circular is available on SEBI website at www.sebi.gov.in under the category: 'Legal → Circulars'.