

Draft Circular on “Treatment of interest income by Clearing Corporations (CCs) on cash collaterals received from Clearing Members (CMs) and upstreamed client funds” for Public Comments

Introduction: In the ordinary course of business, a CC while discharging its functions viz. Clearing and Settlement, Risk Management, etc. is required to keep deposits, collaterals, settlement obligation amounts, etc. from Clearing Members (CMs) and certain portion of such deposits or collaterals comprises cash. Further, in order to safeguard clients’ funds placed with Stock Brokers (SBs)/ CMs, SEBI vide circular dated June 08, 2023 mandated upstreaming of all client funds received by SBs/CMs to the CCs on End of Day (EOD) basis and the said funds shall be upstreamed only in the form of either cash, lien on Fixed Deposits (FDs) or pledge of units of Mutual Fund Overnight Schemes (MFOS) subject to certain conditions.

In recent times, it is observed that the CCs hold substantial amount of cash collaterals from CMs towards settlement obligation and margin money. CCs earn interest or income by investing or deploying such cash collateral received from CMs and upstreamed clients’ funds. The collaterals placed by CMs or their clients are not owned by the CCs, instead it is held in the fiduciary capacity by the CCs as a regulatory requirement specified for Risk Management Framework of CCs.

Public Consultation:

To review the existing practice of interest or income earned by CCs on the cash collaterals received from CMs and upstreamed clients’ funds, the matter was discussed in the Risk Management Review Committee of SEBI (RMRC). Based on the recommendations of RMRC and subsequent deliberations, the draft circular on the captioned matter is placed at **Annexure-A** for public comments.

The comments/ suggestions should be submitted latest by **July 25, 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 send your comments through e-mail to aruns@sebi.gov.in & mrd_pod3@sebi.gov.in with the subject: “Treatment of interest income by Clearing Corporations (CCs) on cash collaterals received from Clearing Members (CMs) and upstreamed client funds” on the proposals at Annexure-A.

Issued on: July 05, 2024



DRAFT CIRCULAR

SEBI/HO/MRD/MRD-PoD-3/P/CIR/2024/xxxx

July xx, 2024

To

All Recognized Clearing Corporations

All Registered Clearing Members

Sir / Madam,

Sub: Treatment of interest income by Clearing Corporations (CCs) on cash collaterals received from Clearing Members (CMs) and upstreamed client funds

1. In paragraph 1.1.1 of Chapter 4 on “Risk Management Framework” of SEBI Master Circular No.SEBI/HO/MRD2/PoD-2/CIR/P/2023/171 dated October 16, 2023 for Stock Exchanges and Clearing Corporations (CCs), it has been stated that the core of the risk management system is the liquid assets deposited by members with the exchanges or clearing corporation and at all points of time such liquid assets shall be adequate to cover the requirements to meet mark to market losses, value at risk margins, extreme loss margins and base minimum capital.
2. Further, as per paragraph 1.1.2 of Chapter 4 of the above mentioned Master Circular, a list of acceptable liquid assets with applicable haircuts have been prescribed. The broad acceptable liquid assets include Cash Equivalents such as Cash, Bank Fixed Deposits (FDRs), Bank Guarantees, Securities of Central Govt., Units of Liquid Mutual Funds & Gilt Mutual Funds and Other Liquid Assets such as Group I Equity Shares, Units of other Mutual Fund Schemes and Corporate Bonds subject to certain conditions.

3. Similar provisions have also been prescribed under paragraphs 9.1.1 and 9.1.2 of Chapter 9 of SEBI Master Circular No. SEBI/HO/MRD/MRD-PoD-1/P/CIR/2023/136 dated August 04, 2023 for Commodity Derivatives Segment.
4. In the ordinary course of business, a CC while discharging its functions viz. Clearing and Settlement, Risk Management, etc. is required to keep deposits, collaterals, settlement obligation amounts, etc. from Clearing Members (CMs) and certain portion of such deposits or collaterals comprises cash.
5. In recent times, it is observed that the CCs hold substantial amount of cash collaterals from CMs towards settlement obligation and margin money.
6. Further, in order to safeguard clients' funds placed with Stock Brokers (SBs)/ CMs, SEBI vide circular No. SEBI/HO/MIRSD/MIRSD-PoD-1/P/CIR/2023/84 dated June 08, 2023 mandated upstreaming of all client funds received by SBs/CMs to the CCs on End of Day (EOD) basis and the said funds shall be upstreamed only in the form of either cash, lien on FDRs or pledge of units of Mutual Fund Overnight Schemes (MFOS) subject to certain conditions.
7. CCs earns interest or income by investing or deploying such cash collateral received from CMs and upstreamed clients' funds. The collaterals placed by CMs or their clients are not owned by the CCs, instead it is held in the fiduciary capacity by the CCs as a regulatory requirement specified for Risk Management Framework of CCs and the cash collaterals are designated as Other Current Financial Liabilities in the balance sheet of CCs.
8. To review the existing practice of interest or income earned by CCs on the cash collaterals received from CMs and upstreamed clients' funds, the matter was discussed in the Risk Management Review Committee of SEBI (RMRC). Based on the recommendations of RMRC and subsequent deliberations, the following have been decided:-

- 8.1. CCs Own funds; and funds received from CMs as cash collateral & upstreamed client funds with the CC shall be segregated at all points of time.
 - 8.2. The CCs can invest or deploy the cash collateral received from CMs and upstreamed client funds in highly liquid financial instruments with minimal market and credit risk in accordance with the investment norms specified by SEBI from time to time for investment of Core Settlement Guarantee Fund (SGF) corpus.
 - 8.3. Interest or income, if any, by the CC out of cash collaterals received from CMs and upstreamed client funds shall periodically (at least on quarterly basis) be distributed to CMs or added to the CMs collaterals, subject to adjustment of costs, taxes, regulatory charges, if any and the benefit of the same shall appropriately be passed on by the CMs to their clients.
9. The above provisions shall not be applicable for the following:
- 9.1. The provisions related to Pay-in shortfall;
 - 9.2. Interest free security deposit placed by the CM with the CC as part of its membership requirements; and
 - 9.3. Wherever any Law prohibits payment of interest to any investor or class of investors {with respect to Cash collaterals placed through CM / Professional Clearing Member (PCM) with CC for Cash and Derivatives segment}.

10. Operational Procedures:

The CCs shall publish the procedures for operationalization of these requirements, including adjustment of any costs, taxes, regulatory charges, if any and the methodology for allocation of interest or income, etc. In order to ensure uniformity, the same shall be implemented under the guidance of the Industry Standards Forum (ISF) of Market Infrastructure Institutions (MIIs) within 60 days from the date of issuance of this circular.

11. **Applicability**

11.1. The provisions of this Circular shall come into force from **90th** day of issuance of this circular.

11.2. In case of CC(s) primarily providing clearing and settlement for agriculture commodity derivatives during last financial year, the provisions of this Circular shall come into force with effect from **365th** day of issuance of this circular.

12. Clearing Corporations are advised to:

12.1. take necessary steps and put in place necessary systems for implementation of above.

12.2. make necessary amendments to the relevant bye-laws, rules and regulations, wherever required, for the implementation of the above; and

12.3. bring the provisions of this circular to the notice of market participants (including investors) and also to disseminate the same on their website.

13. This circular is issued in exercise of the powers conferred under Section 11(1) of the Securities and Exchange Board of India Act 1992 read with Regulation 51 of the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018, to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

14. This circular is available on SEBI website at www.sebi.gov.in .