Consultation Paper on "The facility for Trading in the Secondary Market using UPI Block Mechanism to be mandatorily offered by Qualified Stock Brokers (QSBs) to their clients (ASBA - like facility for secondary market) and other incidental matters"

1. Objective

1.1. To solicit comments from stakeholders and members of the public on whether the facility of Trading supported by Blocked Amount in the secondary market using UPI block mechanism (ASBA-like facility) should be mandatorily offered by Qualified Stock Brokers (QSBs) to their clients, viz. individuals and HUFs. This is currently a non-mandatory facility provided by Trading Members (TMs).

1.2. Comments have also been sought whether a "3-in-1 trading account facility", can be offered by QSBs as an alternative to the above proposed mandatory offering of ASBA-like facility.

1.3. This consultation paper is subsequent to a series of discussions held with multiple stakeholders, including Clearing Corporations (CCs), National Payment Corporation of India (NPCI), QSBs, and Banks, with respect to the challenges being faced in operationalisation of the said ASBA-like facility.

2. Background

2.1. SEBI had introduced the use of RBI approved Unified Payments Interface (UPI) with facility of blocking of funds, as a payment mechanism for retail investor applications submitted through intermediaries for public issues (IPO) from January 2019.

2.2. In view of the significant advances in the payment mechanisms, it was felt that the UPI Mandate service of single block and multiple debits can be integrated with the secondary markets to provide a block mechanism (similar to pledge-like mechanism in securities). Through this, investors would be able to block funds in their own bank account for trading in secondary market, instead of transferring them upfront to the Trading Member (TM). This would in turn provide enhanced protection of cash collateral for the investor, besides allowing the investor to earn interest on such balances.

2.3. Therefore, in January 2024, SEBI introduced a supplementary mechanism for trading in secondary markets by integrating UPI service of single block and multiple debits. Under this facility, the client can trade in secondary market based on blocked funds in his/ her bank account, instead of transferring the funds upfront to the trading member.

2.4. The facility is currently optional for investors, and not mandatory for Trading Members (TMs) to offer as a service to clients. It provides enhanced protection to the client funds and securities, 2.4.1. by giving an option to investors/ clients to trade in secondary market based on blocked funds in one's own bank account thereby eliminating the need to transfer funds to the stock broker, and

2.4.2. by providing client level settlement visibility (both pay-in and pay-out) to clearing corporation (CC) by direct settlement of funds and securities between client and CC.

Thus, the aforesaid process of trading in secondary market through UPI facility by blocking funds, by design, safeguards clients' assets from misuse/ brokers' default and consequent risk to their assets.

2.5. The aforementioned facility of conducting trades in the secondary market using UPI block mechanism, was envisaged to offer the following benefits to clients:

2.5.1. Enhanced safety viz., (i) hassle-free and immediate return of funds and/ or securities in case of TM default; (ii) no impact on pay-out even in case of TM default, (iii) ease of porting to another TM

2.5.2. Funds blocked from savings account shall earn interest for the investor

2.6. Additionally, utilizing the facility of blocking funds in the bank account via UPI for trading in the secondary market also mitigates the following risks within the system:

2.6.1. Risks associated with the reliance on reporting done by members 'Trading Member'(TM) / 'Clearing Member' (CM) for client wise allocation of the collateral placed with the CC - member may report wrong amount.

2.6.2. Possibility of misuse of client cash collateral retained by the members and not passed on to the CC.

2.6.3. Risk associated with wrongful withdrawal of clients' cash collateral by members from CC.

2.6.4. Risk of non-settlement of pay out by TM to clients.

2.7. The Beta version of Trading through Block Mechanism for secondary markets was launched on January 01, 2024, for individuals and HUFs, and was made applicable only to the cash segment. With this launch, the Indian securities markets was placed in the higher orbit of technology stack by enhancing investors' convenience while ensuring that their funds and securities move out of their accounts only on the instructions of the clearing corporation and to the extent of their settlement obligation.

2.8. SEBI anticipates that this mechanism may eventually become a popular method for retail investors, such as individuals and HUFs, to trade in the securities markets, provided that TMs are willing to adopt the system.

2.9. Given the substantial benefits of adopting the UPI block mechanism for trading in the secondary market, a series of meetings were held with CCs, NPCI, TMs and Banks to identify the bottlenecks faced in developing the said facility and also necessary steps required to popularize the framework.

2.10. Significant progress was made in the said meetings with the support of the stakeholders. Some of the notable developments include, issuance of letters to banks urging them to participate in providing the facility of UPI block mechanism to clients, the issue of a circular by NPCI dated July 31, 2024 with respect to enablement of UPI mandate feature of single block multiple debits, and facilitation by developing certain file formats by CCs required by TMs for back office re-conciliation.

2.11. The following paragraphs outline some of the key points from these discussions, requiring further deliberations.

3. Commercial arrangements for NPCI and Banks in providing clients with the facility to trade using the UPI block mechanism

3.1. NPCI, sponsor banks, and customer banks are the foundational pillars to enable the implementation of the UPI block mechanism for trading in the secondary market.

3.2. With the support of these key players in the financial ecosystem, SEBI was able to introduce the Application Supported by Blocked Amounts (ASBA) facility for primary market issuances, making it accessible to the wider public and delivering significant benefits to the entire ecosystem.

3.3. Currently, NPCI has a UPI transaction processing capacity of approximately 15,000 transactions per second (tps). To assess the potential impact of this mechanism on NPCI's UPI system, data on the number of pay-in transactions in the cash segment by clients, including individuals and HUFs, was compared to the total number of UPI transactions conducted nationwide from July 01, 2024, to July 31, 2024. The details are provided in the table below:

Table 1

Particulars	**No. of transactions (in lakh)**
(A) Avg. daily no. of pay-in transactions at NCL	23.23

(B) Avg. daily no. of pay-in transactions at ICCL	7.98
(C) Avg. daily no. of pay-in transactions in total (A+B)	31.21
(D) Avg. daily no. of UPI transactions	4,679
(E) Avg. daily no. of UPI transactions during the time period 8.00 pm – 8.30 pm	200
(F) % of additional no. of UPI transactions which may be contributed due to the facility of UPI block mechanism on a daily basis	0.67%
(G) % of additional no. of UPI transactions which may be contributed due to the facility of UPI block mechanism during the time period 8.00 pm – 8.30 pm	15.61%

**The no. of pay-in transactions have only been considered as the pay-out transactions will be done by the CC using the normal banking channels*

***The pay-in of funds takes place at 8 pm on T day in case of trades undertaken using the UPI block mechanism*

3.4. The table above suggests that even if all clients, viz. individuals and HUFs, switch to using the UPI block mechanism for their trades in the secondary market, this facility will still have adequate processing capacity, both on a daily basis as well as for the time period between 8.00 pm – 8.30 pm i.e., the time period over which the pay-in transactions can be staggered. The existing capacity of UPI, can be utilised to provide the aforesaid facility to the clients.

3.5. Additionally, regarding the commercial arrangement, it can be noted that when NPCI and banks offer the ASBA facility to their clients during primary market issuances, they receive compensation from the issuer according to the agreed terms, as such issuers are the beneficiaries of this service.

3.6. In contrast, for the secondary market, investors executing trades will be the beneficiaries of the UPI block mechanism provided by NPCI and the banks.

3.7. Clients who choose to use the UPI block mechanism for their secondary market trades will primarily benefit from the interest earned on the balances they maintain in their bank accounts. This is because with the UPI block mechanism, these funds remain in their account rather than being transferred to the TM.

3.8. The data regarding the allocated cash collaterals in the cash segment by TMs for clients, viz. individuals and HUFs, was analyzed for the period from July 23, 2024, to July 29, 2024.

3.9. Analysis shows that clients held an average daily cash balance of approximately Rs. 65,276 crore in the cash segment, with their TMs. Assuming an average interest rate of 4% on these cash balances, the total annual interest accrued would amount to roughly Rs. 2,611 crore, for the collaterals held in the cash segment. Note that concomitantly, TMs would stand to lose float income from such balances, and may have to adjust brokerage rates to cover for such loss of implicit income. The overall result would be a more transparent and efficient ecosystem of transaction costs for investors, in a competitive landscape.

3.10. If the clients start to trade in the cash segment of the secondary market using the UPI block mechanism, their current cash balances with TMs are likely to stay in their bank accounts. This would result in significant savings for the clients in the form of interest accrual on cash balances and create a steady stream of low-cost CASA balances for the banks. In the future, if the facility of trading in the secondary market using UPI block mechanism were to be extended for the derivatives segment, it would result in additional benefits for the clients as well as the banks.

3.11. Considering the benefits to clients from earning interest on cash balances in their bank accounts, as well as the advantage to banks from having stable CASA deposits, banks would be free to design their fee structure for offering the UPI block mechanism for secondary market trading.

3.12. Further, it is understood that currently banks do not charge any fees for UPI transactions from their clients.

4. Mandating QSBs to offer the facility of trading in the secondary market using the UPI-based block mechanism to their clients.

4.1. Trading Members (TMs) are classified as Qualified Stock Brokers (QSBs) based on factors such as the size and scale of their operations, including the number of active clients, the total assets held by clients with the TM, the end-of-day margin of all clients, and the trading volume of the TM.

4.2. Being designated as a QSB, brings with it enhanced responsibilities and obligations. Further, QSBs are also subjected to enhanced monitoring by Market Infrastructure Institutions (MIIs).

4.3. The data regarding the number of unique clients (viz. individuals and HUFs) registered with the QSBs as of July 31, 2024 was analysed. Further, the gross traded value of such clients for the period July 01, 2024 to July 31, 2024, was also studied. The details are provided below:

Table 2

Particulars	Clients (viz. Individuals and HUFs) in the cash segment trading through QSBs*	Overall no. of Clients (viz. Individuals and HUFs) trading in the cash segment	%

No. of unique clients registered as on July 31, 2024 (in crs)	5.42	6.51	83
Gross Trade Value in July 2024 (Rs. In crs)	15,79,034	23,17,596	68

Source: NSE

* The QSBs have been identified based on the joint press release of the Exchanges dated July 19, 2024

4.4. The above table shows that approximately 83% of clients viz. individuals and HUFs, contributing approximately 68% of the gross trade value in the cash segment are trading using the services of QSBs.

4.5. Given the scale of their operations, QSBs, as large Trading Members, have the capacity to be leaders in offering technological advancements to their clients. Additionally, it has been observed that QSBs have generally taken the lead in developing the systems necessary to make trading through the UPI block mechanism available to their clients.

4.6. It is also noted that some of the TMs offer the facility of 3-in-1 trading accounts to their clients. In some cases, the facility of 3-in-1 trading accounts may be more readily implementable by TMs. Further, in case of 3-in-1 trading accounts, the clients would have their funds in their bank account, earning interest on the cash balances. In addition, the 3-in-1 facility would be available for cash as well as derivatives segment, without any amount restrictions, while the facility of trading using UPI block mechanism at present shall be available only for cash segment with some restrictions on number of blocks allowed on a daily basis. However, compared to UPI facility, the facility of 3-in-1 trading accounts provide adequate, albeit lower protection to the clients, considering that the pay-in and pay-out of funds is routed through the TMs.

4.7. Public comments are sought on the following:

4.7.1. Whether QSBs should be mandated –

a. To provide the facility of trading using the UPI block mechanism in the cash segment for their clients viz. individuals and HUFs, with an appropriate glide path for implementation, or

b. To provide either the facility of trading using the UPI block mechanism in the cash segment for individuals and HUFs, or the facility of 3-in-1 trading accounts to their clients for both the cash and the derivative segment, with an appropriate glide path for implementation

The answer may be justified with appropriate rationale.

5. Public Comments:

5.1. The comments/ suggestions, with respect to para 4.7 above, may be submitted latest by September 12, 2024, through the following link:

5.2. In case of any technical issue in submitting your comments through web-based public consultation form, you may write to mrd_consultation@sebi.gov.in with the subject: “Issue in submitting comments on Consultation Paper on The facility of trading in the secondary market using UPI block mechanism to be provided mandatorily by Qualified Stock Brokers (QSBs) and other incidental matters”.

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