

Recently there are a lot of discussions going on regarding the new margin pledge rules drafted by SEBI. In today's blog, we are going to discuss the new development and how it's going to impact your trading strategy.

The market watchdog has lately introduced a spate of reforms to safeguard the interests of the investors. From setting norms for reporting of cash at client's level and bank account balance to standardising leverage, all actions culminated in achieving a higher degree of transparency in the stock market. The new margin pledging norms also targets protecting investors' interest.

### **What Is Margin Pledging?**

Pledging, by definition, refers to the process of using your stocks as securities to avail a loan. It functions like any other mortgage loan where you use an asset as a collateral, like gold jewellery in a gold loan. Traders in the F&O segment often use pledging to receive margin funding from the broker to invest in deals that involve sizeable initial investment.

Margin is a popular concept in the world of stock trading. It allows investors to leverage, invest in deals without assuming the full risk at the first stage. When you use pledging, your risk exposure gets limited to the securities you have used as collateral. In case you can't repay the margin, the broker liquidates the stocks in the margin account to recover its debt.

For the securities or funds in the margin account, the broker acts as a custodian. However, on certain occasions, violation of margin collateral was reported to SEBI. Some brokers were found guilty of misusing client funds and collaterals entrusted on them. The new margin pledge policy will help to address this problem. The new rule will implement from September 2020.

### **What Will It Change?**

It will bring in some significant changes to the existing system. The new margin pledging norms are going to be monumental for all involved in stock trading – investors as well as brokers, making margin laws more stringent. The stockbrokers met SEBI on August 18 seeking more time to implement new rules, but SEBI refused.

Here are the key points

- SEBI has made it compulsory for the brokers to collect margin upfront from investors
- It will also put an end to the Power of Attorney practice through which clients used to give authority to the broker to execute transactions on their behalf. The same power of attorney can't be used for margin pledging anymore
- Investors who want to avail margin now have to create margin pledge separately
- Earlier collecting upfront margin wasn't mandatory, but under the new system, investors will have to pay at least 30 percent margin upfront to avail a margin loan
- Upfront margin will be required in cash segment also

In the existing system, investors didn't have to pay upfront margin in the cash segment. For all these years, cash margins were taken care of by the broker. Till November 2019, only investors in the F&O segment required to pay margin upfront. But SEBI has now decided to tighten the margin rules for everyone. Some anomalies were reported to SEBI in the last few years against some unscrupulous brokers who were engaged in misusing a power of attorney assigned to them.

Come September brokers have to collect margin from investors upfront for both buying and selling of securities. The new rule stipulates that all investors need to deposit margin even when they try to sell, meaning an investor who is trying to sell his shares to raise capital is also required to deposit margin first. Failing to do so will attract a penalty. The securities lying in the DEMAT account will not automatically become available to receive margin. The broker also has to report the exchange regarding margin collected from the investors four times a day. The stock margin pledge rules have also made the delivery of securities on the same day mandatory.

The new rules will replace the current process of availing Margin Trade Funding Facility. Shares purchased by investors will stay in the newly created Client Uppaid Securities Account (CUSA) for T+6 days. If you wish to avail margin, you will need to apply within T+1 days by 4:00 pm. If you fail to do so, then the broker can sell the stocks in CUSA account to meet the debit amount.

## **Conclusion**

The new margin pledging norms are attracting a lot of debate. Many have argued that it will make the stock trading process cumbersome and deter many day traders from trading aggressively. Currently, the exchange follows the T+2 day settlement policy under which stocks purchased can be settled in two days. The new norm has implemented the policy to same-day settlement. Further, traders can no longer use funds received from selling a stock A to purchase a stock B. They will now have to pay a fresh margin to buy stock B. However, this might put a stop in margin misuse by brokers and make the system more efficient.

The fee for pledging will remain unchanged, and as a trader, you will have to maintain a cash-collateral ratio of 50:50.

The current system will remain valid till August 31, and the new rules will come into effect from September 1. We will soon update the new process on the creation of margin pledge in our website and will communicate the same to all our clients.