Sebi plans to shorten settlement cycle in a bid to reduce investors' risks

Stock market investors may see the cost of trading coming down and get their funds from sale of shares quicker with capital markets regulator Sebi proposing to shorten the trading settlement cycle to one day after a trade from two days.

Currently, if an investor buys a share on, say, Monday, the shares are credited to her demat account on Wednesday or on a T+2 basis. If Sebi's proposal is accepted, the shares will be credited on Tuesday or T+1 basis instead.

The move will benefit investors who are not be able to arrange funds immediately to buy shares and who depend on their brokers to put up margins for the purchase.

Once the shares are credited to an investor's account, she sells them for a higher price and pays back the broker the margin along with interest, which normally ranges between an annualised 12% and 18%. The broker now charges interest to such investors over a period of two days.

If the T+ 1 settlement is followed, investors will be charged interest only for a day. Secondly, sellers of shares will find their funds being blocked for a day less.

"The financial crisis of 2008 has bought into focus the risks prevalent in the system, the magnitude of which also relates to the length of the settlement cycle. A shortened settlement cycle not only reduces that but also reduces and frees up the capital required to collateralize that risk," Sebi said in a discussion paper seeking public comments by May 20, 2013.

The regulator said a shortened settlement cycle would reduce the number of outstanding unsettled trades at any instant of time, thus decreasing the unsettled exposure to a clearing corporation by 50%. Besides, the time window for a counterparty's insolvency to impact the settlement of a trade will become narrow.

"Trading costs will come down if the settlement cycle gets shortened," said Rikesh Parekh, VP-Markets Strategy and Equities at Motilal Oswal Securities. However, he added that the banking system in nonmetros could face initial troubles in a T+1 settlement as Real Time Gross Settlement (RTGS) system is not used by some of the bank branches in such areas.

Santanu Syam of Angel Broking said clients would benefit as it would reduce the risk of volatility and brokers too would gain as the capital deployed by them will be released in a day itself.

Sebi said the capital blocked in the system to cover the trade risks will get proportionately reduced with the number of outstanding unsettled trades at any point of time. However, a stock exchange official said the T+1 settlement may not have any major impact as delivery based volumes are very insignificant and exchanges already collect margins on T+0 basis from brokers.

T+1 settlement can be a major benefit when cash market traders or delivery-based settlements pick up in a big way. The regulator also said that the market structure should be sound enough not to expose investors to operational and credit risk of brokers or trading members. Therefore, the risk to client collateral needs to be mitigated. At present, Sebi rules mandate segregation of client money and securities deposited as collateral with broker, which is required to ensure that client collateral is not used for any purposes other than meeting the respective client's margin requirements.

The regulator said although one the models proposed protects interests of client onbroker default, it should not be at the cost of ignoring broker interests on client default.

Thus, the model should ensure both that client collateral is protected in case a client has fulfilled its obligations and that client collateral is available to a broker in case of non-performance of obligations by client.

Currently, in case of dispute, since the client collateral is with broker, the broker uses that to fulfill any obligation towards clearing corporation on account of client trades pending decision on dispute. In case decision of dispute goes in favour of client, broker settle a client's claim.

The regulator has also proposed to incentivise internet-based trading model by waiving off any margin requirements by the clearing corporation as funds and securities are already blocked on behalf of the clearing corporation.

Currently, an investor putting in an internet based trade must have 100% margin. As there is no risk of default involved, Sebi proposed that the clearing charge for such clients should be reduced.

(Economic Times)