Our View

New Pledge and Re-pledge system: A good start, next should be Real-Time Securities Settlement

In my view, there have been three truly watershed moments in the history of Indian Capital Markets. First was in 1994, the launch of NSE which enabled the migration from a physical outcry trading floor for equities to a complete electronic trading platform. The second, in 1996, was the dematerialization of securities, which rid us of the pain of physical share certificates and manual shares transfer. And the third was when the Indian regulator decided to ban the indigenously evolved traditional stock financing system called 'Badla' and later replaced it with the options and futures market in 2001.

Apart from bringing in transparency, these developments undoubtedly did wonders by increasing the trading volumes and lending more depth and resilience to the market. They offered a seamless and transparent trading backbone providing great ease of access to investors. The common underlying factor driving all these changes was the use of technology. Having witnessed the implementation of all these path-breaking initiatives, I would say that each time such offbeat and progressive ideas are introduced by the regulators, there is usually a general discomfort in the trading community. Murmurs about the havoc such changes could trigger are always abound. This is quite understandable as these are revolutionary and unconventional steps.

The current decision of SEBI to streamline the margin money mechanism through Pledge and Re-pledge (PRP) is another such radical use of technology. The requirement for pledge of securities arises because investors and brokers are required to provide upfront margin money for every trade they do. This margin money can be in the form of cash, idle shares lying in the demat account that could be pledged, government securities or bank fixed deposits.

The question that comes up is why did we need this change? In the earlier system the brokers took a Power of Attorney (PoA) from their clients which allowed them to access their clients' demat accounts. This was required for the brokers to move the shares from client account to a separate account for the purpose of collateral for margin money. The shares were further transferred to the clearing corporation as margin. Unfortunately, this arrangement was prone to misuse and there were situations of such nature. Therefore, SEBI's decision to replace the PoA system by the PRP system is a definite step forward towards a more robust process. Under the new system, clients just need to pledge the shares lying in their depository accounts with NSDL or CDSL in favor of the broker and the same are available for repledge to the clearing members. So now, the securities remain in the client's account with the depositories and need not be transferred out to any other account.

There are several advantages of this new system introduced by SEBI. First, now the shares or securities of one investor cannot be used as margin money for any other investor. There is no possibility of intermingling of securities. Secondly, shares or securities of unknowing or inactive investors cannot be pledged to Banks/ NBFCs for financing another account. Finally, since securities would not leave the actual owner's demat account, the corporate benefit on them would continue to accrue to the owner.

As it often happens in any new system implementation, there could be teething issues in the initial roll-out which has led to a drop in the trading volume. Of course, it is compounded by the fact that some market intermediaries were expecting a deferral of the new process and were not entirely prepared for it. I believe as an immediate action this is a good attempt by SEBI to streamline this area of concern using technology.

In my view though, in the long term this is still a penultimate step. The way we took the lead in moving the entire trading platform to online system, the way we moved from physical to electronic shares, we need to move to a Real-Time Securities Settlement (RTSS) system. Though I am no expert of technology, taking a cue from Real-Time Gross Settlement (RTGS) in place for transfer of funds, this seems very doable. And given the brilliant track record of this government in digital initiatives like Aadhar, digital health record, faceless income-tax assessment and appeals, am sure this can be conceptualized and executed seamlessly. It will surely be another big feather in the cap of our capital markets which already is one of the most efficient markets in the world.

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