Sebi to revamp, tighten stock exchange and trading norms

Sebi is revamping trading norms to strengthen its scrutiny of defaulters and mitigate liquidity risks arising out of increased algorithmic trading

The Securities and Exchange Board of India (Sebi) is planning a makeover for stock trading rules and some of the key norms governing stock exchanges, clearing corporations and market intermediaries such as brokers and depository participants (DPs).

About a month ago, Sebi commenced a study of markets, trading behaviour, functioning of intermediaries and the ability of institutions such as exchanges and clearing corporations to handle increased market activity, two people familiar with the development said, requesting anonymity as they are not authorized to speak to reporters.

They said the capital markets regulator is revamping norms to strengthen its scrutiny of defaulters, enhance transparency in dealings between market participants and mitigate liquidity risks arising out of increasing algorithmic trading.

One of Sebi's top priorities is to tighten surveillance and risk management norms for stock exchanges so that they are able to collect more elaborate data on trading, price movements and dealings between market participants.

"Sebi is reviewing the current norms meant for market intermediaries and trading. In the case of stock exchanges, the surveillance mechanism and the checks and balances carried out need to be changed. The exchanges' supervision on markets, trading activities and price movements have to be improved," said one of the two people.

An email sent to Sebi on Friday went unanswered.

The ongoing study also aims to improve the quality of investigations that Sebi conducts. The new norms, likely to be implemented in the fiscal year starting April, are also aimed at protecting markets from potential liquidity risks and defaults by intermediaries in the event of unprecedented market behaviour, the second person said.

"We need to change the margining system, price-band rules and the technology employed by exchanges. Some additional risk-management measures will also be introduced. Sebi is taking suggestions from exchanges and some other regulators in developed nations," said the second person.

Every stock has different price-bands or circuit filters, within which it is allowed to be traded. Similar filters are applied to indices. On BSE, the daily price bands for listed companies vary from 2% to 20%. Sebi may tighten price-band norms, introduce new types of margins on trading and tighter margin trading rules, especially institutional ones. The new norms would also enable exchanges to have stronger price monitoring, position monitoring and investigation abilities.

At present, as a part of risk management, exchanges are required to collect various types of margins from brokers and trading members.

The margin trading mechanism allows an entity to trade in equities on an intraday basis and place a buy order for securities without immediately paying for them and a sell order without actually possessing them.

Trades are typically squared off for an entity once its net liquidation value reaches 85-95%. Net liquidation value is the value of an entity's cash plus the market value of its long positions after deducting the market value of securities it holds in short positions.

Since high-frequency trading (HFT) in the market is increasing, it is imperative for Sebi to ensure that retail investors (who typically do not use HFT) are not discriminated against, said J.N. Gupta, co-founder and managing director of proxy advisory firm Stakeholder Empowerment Services and a former executive director of Sebi.

"If Sebi finds an empirical evidence that due to HFT the current price-band norms are putting retail investors at a disadvantageous position vis-à-vis sophisticated investors, Sebi should change the norms pertaining to price-bands on stocks traded. It is possible that due to HFT many stocks are exposed to the risk of hitting their lower or upper price bands too quickly. This may put retail investors at a disadvantageous position because they won't be able to see their trades being executed if HFT in bulk happens to take a stock to its circuit limits too quickly," Gupta said.

Another key issue that Sebi wants to address through the new norms is to strengthen its scrutiny of market participants so that it is able to collect better evidence against alleged defaulters.

"Monitoring and surveillance activities need improvements also because it is important for Sebi to get better data on trades. This will help Sebi to pass better orders that can hold a stronger ground in the court of law. This is one of Sebi's biggest worries at present," said the second of the people cited earlier.

Gupta said that, currently, exchanges only provide trade data on volumes and turnover.

"If exchanges are able to provide this data along with unique client codes, it will be much easier for Sebi to figure out whether any manipulation in stocks has happened or not," Gupta said.

According to a 13 January *Mint* report, in 2016, **one out of every three Sebi orders that was challenged at the Securities Appellate Tribunal (SAT) was referred back to the regulator** by the appellate body. In all, 220 out of 750 cases heard at SAT were remanded back to Sebi. This is a jump from the 20% and 9% referral rates seen in the last two years respectively.

(Live Mint)