

# SEBI REDEFINES 'PLEDGE' TO PROTECT CLIENT SECURITIES

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Capital Market & SEBI

A minor tweak in the manner 'pledge' is defined in the regulatory laws is expected to go a long way in minimising instances where stock brokers misuse client securities by pledging such shares for their own benefit in terms of meeting their margin requirements.

The Securities and Exchange Board of India (SEBI) has amended the SEBI (Depositories and Participants) Regulations by including an additional explanation that states that 'pledge' would also refer to 're-pledge of securities for margin or settlement obligations.'

The decision was approved by the board of the capital markets regulator on Monday.

"Onus of bonafide pledge created from margin account of a stock broker will now lie with the depository following the SEBI amendment," Makarand Joshi, partner, MMJC and Associates, a corporate compliance firm, said.

"In the past, pledge from the margin account was directly routed by the stock broker using the power of attorney route, without the active consent or approval of the beneficiary holder of shares. Now consent of beneficial owner will be necessary," he added.

This assumes significance as the recent past has seen few instances of brokers pledging client securities to raise funds from banks and non-banking finance companies (NBFCs). More importantly, this was done without the clients being aware that their securities were being misused in such a manner.

The most high-profile matter in the recent past was of Karvy Stock Broking in which the Hyderabad-based firm raised funds from entities such as Bajaj Finance, ICICI Bank, HDFC Bank and IndusInd Bank by pledging client securities.

Further, according to the lenders — as stated in an order by the Securities Appellate Tribunal — Karvy Stock Broking had even given an undertaking that the securities that were being pledged were its own and that they did not belong to clients.

## 'Misuse will come down'

"Instances where a client's funds/securities were diverted or misutilised by brokers toward margin or settlement obligations of itself, or for some third party, or for raising loans against shares on its own account, will be minimised," said Sumit Agrawal, founder, RegStreet Law Advisors, and a former SEBI official.

"With the insertion of this explanation, depository participants of both the pledger and the pledgee will have to inform the pledger and the pledgee respectively of the entry of creation of the re-pledge," he added.

The latest SEBI move comes close on the heels of the regulator developing an in-house system to track the movement of client securities that are collected as collateral by the brokers.

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