Bank financing for margin trading

DBOD.BP.BC 27/21.04.137-2001

September 22, 2001

All Scheduled Commercial Banks
(excluding RRBs and LABs)

Dear Sir,

<u>Bank financing for margin trading</u>

Please refer to circular DBOD.BP.BC.119/21.04.137/2000-2001 dated 11th May 2001 setting out the revised guidelines for bank financing of equities and investments in shares.

2. The RBI- SEBI Technical Committee has examined the issues involved in introducing "margin trading." Keeping in view the present circumstances in the capital market and the economy, the Committee has recommended that margin trading should be permitted by banks in India.

3. Based on the recommendations of the RBI-SEBI Technical Committee, on an experimental basis, it has been decided to permit banks to extend finance to stockbrokers for margin trading within the overall ceiling of 5% prescribed for exposure of banks to capital market in the aforesaid circular of May 11, 2001. Banks may accordingly provide finance to brokers for margin trading in actively traded scrips forming part of the NSE Nifty and the BSE Sensex, subject to the guidelines indicated in paragraph 5 below.

4. The guidelines will be valid for a period of 60 days, (i.e., up to November 22, 2001). The working of the guidelines will be reviewed in the light of experience gained and fresh instructions will be issued thereafter.

5. Banks desirous of extending finance to stockbrokers for margin trading should observe the following guidelines :

(a) <u>Minimum margin</u>

A minimum margin of 40 per cent shall be maintained by banks on funds lent for margin trading.

(b) Risk management

(i) The shares to be purchased with margin should be in dematerialised mode, under pledge to the lending bank.

(ii) The banks should put in place appropriate systems for monitoring the margin (40 per cent). If the stockbroker / client fails to meet the margin calls, the lending bank should liquidate the collateral / shares purchased immediately and adjust the loan.

(iii) The bank's Board should prescribe necessary safeguards to ensure that no "nexus" develops between inter-connected stock broking entities / stockbrokers and the bank in respect of margin trading. Margin trading should be spread out by a bank among a reasonable number of stockbrokers and stock broking entities. Stockbrokers, availing of margin trading facilities from a bank should be prohibited from lending, directly or indirectly, to their own connected entities, relatives or business associates or those of the promoters / Directors of the bank through this facility. Banks should also put in place appropriate systems to ensure end-use of funds lent under margin trading.

6. Valuation and disclosure

In addition to the disclosure requirements indicated in the paragraph 13 of the Annexure to the circular of May 11, 2001, banks should disclose the total finance extended for margin trading in the "Notes on Account" to their Balance Sheets.

7.Other conditions:

In other respects, the terms and conditions as set out in the Circular DBOD. BP. BC. 119 / 21.04. 137/ 2000-2001 dated May 11, 2001 would apply.

Please acknowledge receipt.

Yours faithfully,

(K. Seetharamu)
Chief General Manager