Corpsec Hotline

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SEBI INTRODUCES DIRECT MARKET ACCESS FACILITY

Market regulator Securities and Exchange Board of India ("**SEBI**") vide press release dated April 03, 2008 bearing reference number MRD/DoP/SE/Cir-7/2008 ("**Press Release**") issued a circular to the National Stock Exchange and the Bombay Stock Exchange informing them that, while ensuring conformity with the provisions of the Securities Contract (Regulations) Act, 1956 (42 of 1956), they may facilitate Direct Market Access ("**DMA**") for investors.

At present, clients have to contact brokers to give their buy\sell orders and it is only after manual intervention by brokers that the order gets executed. DMA is a facility which allows brokers to offer clients direct access to the exchange trading system through the broker's infrastructure without manual intervention by the broker. As of now, under the Press Release, the DMA facility is restricted only to institutional investors and both the exchanges will have the discretion to allow other category of investor's to access this facility in due course. By this facility, Foreign Institutional Investors (FIIs) and domestic institutions such as mutual funds and insurance firms can directly execute their buy and sell orders without any manual intervention by brokers.

DMA is already well-established in some of the world's more developed markets like the United States, Europe and Australia. Globally, investor preferences are increasingly aligned to more efficient markets where trades are fully electronic and offer investors more control over their trade executions.

With the DMA facility becoming operative, investors will enjoy immediate execution of trade orders at a faster speed. By automating the trade order process, DMA provides investors greater control over trading execution and strategies. In addition, it will also widen the spectrum of trading activities to include higher value added trading activities such as market-making, algorithmic and basket trading to take place.

DMA refers to electronic facilities offered by brokers to their clients, which will in turn enable them to place orders directly into the exchange traded system. In electronic financial markets, algorithmic trading, also known as algo, automated, black-box, or robo trading, is the use of computer programs for entering trading orders with the computer algorithm deciding on certain aspects of the order such as the timing, price, or even the final quantity of the order. In its simplest form, algorithmic trading could be based on a program designed to detect an arbitrage opportunity between the cash and the futures market and place orders on exchanges in real time.

The Stock Exchanges may facilitate DMA subject to the following conditions being fulfilled:

- Brokers interested in providing the DMA facility to their clients shall apply to the stock exchanges giving details of the software's and the systems proposed to be used, which shall be duly certified by the Security Auditor as reliable.
- All DMA orders shall be routed to the exchange trading system through the broker's trading system.
- The broker shall be fully liable and responsible for all orders emanating through their DMA systems. It shall be the broker's responsibility to ensure the fulfillment of eligibility criteria of their clients.
- Brokers shall specifically authorize their clients for providing DMA facility after fulfilling the Know Your Client requirements and carrying out due diligence on client's creditworthiness.
- The broker shall also enter into a specific agreement with the client permitting the use of DMA facility.
- The broker shall ensure that the trading limits/ exposure limits position limits are set for all DMA clients based on the creditworthiness of the client, risk assessment and available margins of the client.
- Brokers using DMA facility for routing client orders shall not be allowed to cross trades of their clients with each other. All orders must be offered to the stock exchange for the matching.

Implications:

Currently, all investors, both institutional as well as retail, place their orders with brokers and the brokers, in turn, enter them into the exchange's system. This loss of time reduces the profit-making potential of program traders and arbitrageurs who do not have direct access. The DMA facility will substantially reduce the loss time and opportunity for such investors.

This may be a welcome move especially for FIIs who may now not need to depend on a domestic broker for execution of a trade giving them a significant operational freedom while dealing in Indian securities.

Interestingly, one needs to examine whether on account of the fact that the computer servers of the broker through which the offshore clients trade from outside of India could potentially create Indian tax issues akin to those raised in the past in relation to taxation of e-commerce transactions.

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- **Sambhav Ranka**, **Sahil Shah** & **Vyapak Desai**
You can direct your queries or comments to the authors

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