**MEMO# 22598**

June 9, 2008

# Institute's Second Letter to Securities and Exchange Board of India - Margining of Institutional Trades

[22598]

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TO: INTERNATIONAL COMMITTEE No. 14-08
INTERNATIONAL INVESTING SUBCOMMITTEE No. 4-08 RE: INSTITUTE'S SECOND LETTER TO SECURITIES AND EXCHANGE BOARD OF INDIA - MARGINING OF INSTITUTIONAL TRADES

In March 2008, the Securities and Exchange Board of India (SEBI) issued a circular describing margin requirements for purchase and sale transactions by institutional investors, including US-registered investment companies, with a first phase effective date of April 21, 2008 and a second phase-in date of June 21, 2008. [1] The first phase-in date contemplated payment of margin on a T+1 basis and the second phase-in date required payment on T+0.

The Institute submitted a letter on April 14, 2008 addressing the issues raised for US-registered investment companies (US Funds) by an upfront margin requirement. [2] On April 17, 2008, SEBI issued guidance permitting an early pay-in on T+1, in lieu of an upfront margin payment. [3] On May 22, 2008, SEBI announced that it would not proceed with the second phase-in until further notice. [4]

On June 6, 2008, the Institute submitted a letter to SEBI. The letter states that the Institute strongly supports SEBI's decision to not proceed with the second phase-in, however, the Institute still wishes to explain the substantial issues and challenges that a T+0 regime would present for US Funds if SEBI reconsiders implementing a T+0 requirement. We state that a T+0 regime would present greater challenges for US Funds than the T+1 requirement and, in some cases, US Funds may consider the challenges and risks too significant to continue to invest in the capital markets of India. The letter identifies the following key concerns for US Funds with a T+0 requirement:

- Challenges with Currency Conversion and Issues with INR Balances: To meet a T+0 payment, a US Fund would have to convert USD on T+0 or have sufficient INR available for payment. US Funds, however, are not generally able to convert USD into INR on a same-day basis and INR balances present regulatory and practical issues.
- Detrimental Impact on Portfolio Management: Without the ability to generally convert USD in time for a T+0 payment, US Funds would be forced to maintain INR balances, increasing currency risk and forcing US Funds to commit additional assets to fund INR balances. US Funds, like other foreign institutional investors (FIIs), may not earn interest on those balances, resulting in additional costs as assets must remain in an account with no interest.
- Increased Operational Risks: US Funds follow strict trade validation processes, including procedures to confirm correct trade execution before directions are given to a sub-custodian to release funds. A T+0 requirement would compromise the process and custodians would have to act only on a broker's trade instructions. It is unclear if US Funds or custodians would be willing to enter into such an arrangement. The T+0 requirement also alters the settlement cycle increasing a US Fund's risk exposure in this cycle.
- Legal Restrictions on Borrowing by US Funds: Arrangements permitting third-party payments on behalf of a US Fund, such as by brokers, pose regulatory issues. Indian regulations prohibit the extension of credit to FIIs and US law strictly limits the ability of US Funds to enter into lending arrangements.

The issues are described in more detail in the letter. The letter requests that SEBI refrain from implementing the T+0 requirement. Finally, we state that if SEBI reconsiders implementing the T+0 requirement that SEBI consider the substantial issues raised for US Funds and provide sufficient notice so US Funds can fully evaluate whether they can continue to invest in Indian securities and if not, to implement an orderly plan of sale of their Indian securities.

Susan Olson
Senior Counsel - International Affairs

Attachment

**endnotes**

[1] See SEBI Circular no. MRD/DoP/SE/Cir-06/2008 (March 19, 2008) regarding “Margining of institutional trades in the cash market” (Circular). Circulars issued by SEBI are available at http://www.sebi.gov.in/Index.jsp?contentDisp=Section&sec_id=1

[2] See Memorandum [22429], International Committee No. 12-08 (April 15, 2008).

[3] See SEBI Circular no. MRD/DoP/SE/Cir-10/2008 (April 17, 2008).

[4] See SEBI Circular no. MRD/DoP/SE/Cir-18/2008 (May 22, 2008).