

Discussion paper on “Review of Ownership and Governance norms for facilitating new entrants to set up Stock Exchange / Depository”

1. Objective

To solicit comments and inputs from stakeholders and members of public on proposed changes to the regulatory framework of Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 (hereinafter referred to as “SECC Regulations”), and Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018 (hereinafter referred to as “D&P Regulations”), related to ownership, governance, and other related matters, with an objective of facilitating new entrants to set up a Stock Exchange / Depository.

2. Background

- 2.1. SECC Regulations and D&P Regulations, *inter alia*, prescribe regulatory framework for ownership, governance and regulation of Stock Exchanges and Depositories (for the limited purpose of this paper, they are hereinafter referred to as “Market Infrastructure Institutions”/ “MIs”), respectively. These norms have been reviewed and revised over a period of time taking into consideration that MIs are in the nature of public utilities, are systematically important entities and have been vested with regulatory responsibilities by various statutes.
- 2.2. The aforementioned regulatory frameworks also mandate constitution of statutory functional and oversight committees at MIs including the composition and functions of the said committees.

3. Need for review

- 3.1. The Indian securities market has been characterized by dominant level of market concentration by a single entity in the trading and depository space. Since, stock exchanges and depositories fundamentally represent the intersection of technology and markets, there is a concern that excessive concentration may lead to abuse of one’s dominant position in the business as well as institutional tardiness in responding in a timely manner to the changing dynamics of capital markets ecosystem. Entities may fall behind the curve in embracing innovations which have a direct bearing on enhancing efficiency in trading and record-keeping space and improving supervision and risk management practices. There is a need, therefore, to forge a competitive landscape in MIs’ space through creating an enabling ownership framework which facilitates not only the entry of new players but also enables merger/ acquisition of the existing entities in/ by the new players who may like to challenge other MIs in their already established domain.
- 3.2. Another dominant trend shaping the exchange and depository landscape is the emergence of new technologies such as distributed ledger technology, artificial

intelligence, machine learning etc. The distributed ledger technology (blockchain) has the potential to disrupt any institution that is engaged in centralized aggregation of trading orders (stock exchange) or as centralized ledger keeper (depository). New developments / experiments are taking place in this arena across various jurisdictions such as USA, U.K, Australia etc. For instance, the London Stock Exchange Group (LSEG) in U.K. and NASDAQ in USA are deploying the blockchain technology to overhaul their trading processes and supervisory mechanisms. Several new fintech / techfin players have also emerged in trading space in these jurisdictions, who are increasingly deploying these disruptive technologies and challenging the traditional functioning of MIs.

- 3.3. These new-age tech firms, who may wish to set up MIs in India need to be incentivized through suitable relaxation in the ownership framework. Therefore, it is imperative to recast the legal / regulatory framework in order to leverage the benefits of such technologies and to incentivize Techfin / Fintech players to enter the Indian MIs' space.
- 3.4. The extant framework caps the ownership of MIs at a lower shareholding limit (not more than 5%) for individuals (domestic or foreign) and institutions (domestic or foreign) in general and permits only up to 15% ownership stake by select category of institutions (domestic or foreign). Current shareholding limits were prescribed with the objective of achieving a diversified ownership structure of MIs in line with the recommendations of the Bimal Jalan committee (2010) on 'Review of Ownership and Governance of Market Infrastructure Institutions' and R. Gandhi committee (2018) on 'Review of regulations and relevant circulars pertaining to Market Infrastructure Institutions (MIs)' which emphasized the public utility role of MIs in furthering the larger economic and regulatory interests of the market.
- 3.5. One of the unintended consequences of this requirement has been that it inhibits new entities to enter the MIs' space and also acts as a hindrance in acquisition of existing entities. The current ownership framework imposes a default precondition of dispersed shareholding at the time of setting up of a MI. This deprives the promoter / potential entrant of a chance to exercise sufficient control thereby limiting the upside gains arising out of entrepreneurial capital to the extent of one's shareholding. In contrast to the securities markets, the norms for ownership in the banking and insurance sectors in India are substantially relaxed with no limits on shareholding for promoters, at the initial stage of setting up of the business *albeit* subject to a phased dilution of shareholding overtime. Therefore, a liberalized framework in the MIs' landscape may be designed by allowing higher shareholding at initial / inception stage and thereafter, prescribing a dilution in the ownership over a period of time.
- 3.6. Furthermore, the operationalization of the interoperability framework in the Indian securities market has resulted in unbundling of clearing and trading

functions, benefitting a potential new stock exchange by allowing it to use the services of existing clearing corporations (CCs).

- 3.7. Along with the need to revamp the current regulatory framework relating to ownership of MIs, with an aim to weed out impediments which may be acting as “barrier to entry”, by entities who may otherwise be willing to operate an MI in India, it is also felt that the specific framework relating to the governance of MIs needs to be reviewed.
- 3.8. Towards this end, SEBI had constituted an Internal Working Group (IWG) on September 10, 2020 to review the extant regulatory framework with respect to ownership and governance norms for Stock Exchanges and Depositories. IWG examined the framework relating to ownership and governance of MIs in major international jurisdictions and also such extant framework in other sectors in India viz. Banking and Insurance. IWG observed that there exists quite a liberal framework on ownership and governance both in major international jurisdictions as well as in Banking and Insurance sectors in India as compared to those for MIs in Indian Securities Market.
- 3.9. The IWG submitted its reform proposals to the Committee of Whole Time Members (WTMs) formed for the purpose of guiding the IWG on certain high level principles to be followed while proposing reforms. The Committee of WTMs reviewed the proposed changes in light of the changing regulatory landscape and further recommended certain modifications to be made in the proposed reforms.
- 3.10. Accordingly, the proposed reforms are as under:

4. Proposals

4.1. Changes relating to Ownership Requirements

- 4.1.1. The key ownership norms that are proposed to be reviewed along with the proposed norms for MIs are as under:

Existing	Proposed
1. Individuals (Resident or Foreign) either directly or indirectly, either individually or together with persons acting in concert, cannot hold more than 5% in a stock exchange or a depository.	A. In case of setting up a new MI Resident Institutions (resident and Controlled) / Domestic Owned and 1. MI shall be a public limited company.

2. Certain institutions (stock exchange, depository, banking company, insurance company, both domestic and foreign, domestic public financial institution, foreign commodity derivatives exchange and a bilateral or multilateral financial institution approved by the central government) either directly or indirectly, either individually or together with persons acting in concert, cannot hold more than 15% in a stock exchange or a depository. 3. Other entities (Domestic or Foreign) either directly or indirectly, either individually or together with persons acting in concert, cannot hold more than 5% in a stock exchange or a depository. 4. Combined holdings of all persons resident outside India cannot cross more than 49% in a stock exchange or a depository.	2. The promoter* setting up the MII may, directly or indirectly, either individually or together with persons acting in concert, hold up to 100% shareholding. 3. The shareholding of such promoter, directly or indirectly, individually or together with persons acting in concert, shall be brought down to not more than (either 51% or 26%) in 10 years from the date of commencement of business. Foreign Individuals / Entities 4. Foreign individuals / entities, who belong to / are regulated in FATF member jurisdictions respectively and are setting up the MII (as promoter), may directly or indirectly, either individually or together with persons acting in concert, hold up to 49% shareholding. 5. The shareholding of such foreign promoter, directly or indirectly, individually or together with persons acting in concert, shall be brought down to (either 26% or 15%) in 10 years from the date of commencement of business. 6. In the event of revocation / withdrawal of the membership of any jurisdiction from the FATF, individuals belonging to / entities regulated in such jurisdiction, shall be required to bring down their shareholding in the MII to not more than 10% in five years from the date of such revocation / withdrawal. 7. Foreign individuals / entities other than those at Para A.4 above, may, directly or indirectly, individually or together with persons acting in concert, acquire or hold up to 10% in a MII. 8. Combined holdings of all persons resident outside India in a MII, shall not exceed, at any time, to 49% in terms of consolidated FDI Policy 2020.
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	Any person (domestic or foreign), other than the promoter and except those mentioned at Para A.6 and A.7 above, may directly or indirectly, either individually or together with persons acting in concert, acquire or hold less than 25% shareholding. In addition to the above, the applicant / promoter (both domestic and foreign), shall comply with the following for setting up a MII; 9. No conflict of interest 10. At least 50% of ownership of the proposed MII, shall be represented by Individuals / Entities having experience (5 years or more) in areas of capital markets or technology related to financial services. B. In case of existing MIIs Individuals / Domestic Institutions (Resident Owned and Controlled) 1. A person may, directly or indirectly, either individually or together with persons acting in concert, may acquire or hold up to 100% shareholding in a MII: Provided that any acquisition of 25% or more shall be subject to prior approval of SEBI and compliance with provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (in case of both, listed or unlisted MII). 2. In case of acquisition beyond 25%, the shareholding of such person (as referred at Para B.1 above), directly or indirectly, individually or together with persons acting in concert, shall be brought down to the level as applicable in case of setting up a new MII (i.e. either 51% or 26%) in 10 years from the date of closure of open offer.
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	Foreign Individuals / Entities 3. Foreign individuals / entities, who belong to / are regulated in FATF member jurisdictions respectively may directly or indirectly, either individually or together with persons acting in concert, acquire or hold up to 49% shareholding in a MII. Provided that any acquisition of 25% or more shall be subject to prior approval of SEBI and compliance with provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (in case of both listed or unlisted MII). 4. In case of acquisition beyond 25%, the shareholding of such person (as referred at Para B.3 above), directly or indirectly, individually or together with persons acting in concert, shall be brought down to the level as applicable in case of setting up a new MII (i.e. 26% or 15%) in 10 years from the date of closure of open offer. 5. In the event of revocation / withdrawal of membership of any jurisdiction from the FATF, individuals belonging to / entities regulated in such jurisdiction, shall be required to bring down their shareholding in the MII to not more than 10% in five years from the date of such revocation / withdrawal. 6. Foreign individuals / entities, other than those mentioned at Para B.3 above, may, directly or indirectly, individually or together with persons acting in concert, acquire or hold up to 10% in a MII. 7. Combined holdings of all persons resident outside India in a MII, shall not exceed, at any time, to 49% in terms of consolidated FDI Policy 2020.
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* For the purpose of this discussion paper, promoter shall mean a person as defined under sub-section (69), section 2 of the Companies Act, 2013

- 4.1.2. Any merger & acquisition in a MII shall be subject to prior approval from SEBI.
- 4.1.3. Prior approval of SEBI shall be mandatory for acquisition exceeding 10%.
- 4.1.4. The existing provisions regarding shareholder(s) being fit and proper person, and the restriction on shareholding of trading member or clearing member or their associates and agents shall continue to apply.
- 4.1.5. All foreign individuals / entities who acquire shares in a MII shall be required to comply with the norms for identification of Beneficial Ownership as stipulated under PMLA Rules.
- 4.1.6. All other extant ownership norms including net worth requirements shall continue to apply.

4.2. **Changes relating to Governance Requirements**

The Internal Working Group (IWG) is of the opinion that governance of MIIs need to be further strengthened to ensure enhanced supervision and accountability so that MIIs fulfill their role as public utilities and first level regulators. It is therefore, desirable to have a more diversified composition of statutory committees at MIIs.

- 4.2.1. The current and the proposed changes in the composition of the regulatory committees at MIIs are as under:

Name of the Committee	Current Composition	Proposed Composition	Rationale
Functional Committees			
Grievance Redressal Committee (GRC)	- Only Independent External Persons (IEP). - One member for claims less than Rs. 25 lakh. - Three members (including one technical member) for claims exceeding Rs. 25 lakh.	One out of three members in the GRC should be PID in case of claims exceeding Rs. 25 lakhs.	PID's inclusion in GRC would serve to boost investors' confidence in the grievance redressal process. This will also boost the corporate governance practices while dealing with aggrieved investors

Name of the Committee	Current Composition	Proposed Composition	Rationale
Nomination and Remuneration Committee	1. Only PIDs 2. IEPs may be inducted in NRC only for recommending selection of MD & CEO.	1. Two PIDs and equivalent number of shareholder directors, if available. 2. IEPs may be inducted in NRC only for recommending selection of MD 3. MD & CEO shall be permanent invitee to the committee, except when his/her appointment/compensation/performance appraisal is being considered	To facilitate wider stakeholder participation as currently only PIDs take critical decisions w.r.t. appointment at sensitive positions.
Oversight Committees			
Standing Committee on Technology	1. At least two IEPs proficient in tech 2. At least 50% PIDs	1. MD & CEO and Chief Technology Officer (CTO) to be permanent invitees 2. All other norms to be retained	The mandate of the committee is to monitor adequacy of systems along with other technology requirements and require proficient people. The proposed composition shall facilitate better decision making and risk management.

Name of the Committee	Current Composition	Proposed Composition	Rationale
Regulatory Oversight Committee.	1. Only PIDs and IEPs 2. At least 50% PIDs 3. Shareholder Directors (SHDs) and KMPs may be invitees to the committee	1. May comprise of PID, SHDs (including MD & CEO) and IEP 2. KMPs may be invitees to committee 3. At least 50% PIDs	Mandated to oversee functioning of exchange and depositories, compliance with SEBI inspection report observations and implementation of SECC Regulations and SEBI(D&P) Regulations Participation from all categories to ensure compliance. Being an overseeing function, PIDs shall be in majority.
Risk Management Committee	1. PIDs & IEPs only 2. At least 50% PIDs	1. At least two PIDs along with IEPs, and a SHD (including MD & CEO) 2. At least 50% PIDs	Since the committee deals with formulation of risk management policy, it should have a balanced representation from all stakeholders.

4.2.2. At present, MD & CEO of a MII can be appointed for maximum two terms of up to 5 years each, with an age limit of 65 years. It is proposed that the appointment of MD & CEO of the MII shall be for maximum three terms of three years each, subject to age limit of 65 years. The requirement of conducting afresh appointment process for appointment of MD, post each term, shall continue to apply.

4.2.3. Other extant governance norms including MIIs' Board composition requirements shall continue to apply.

5. Public Comments

- 5.1. Any rational change in regulatory framework can be achieved by participation of and contributions from various stakeholders. Thus, comments are solicited on the proposal mentioned at point 4 above, including the following:
- 5.1.1. Whether the proposed shareholding referred at Para 4.1.1 (A.3) and Para 4.1.1 (B.2), for resident individual / domestic institutions, should be brought down to 51% or 26%?
- 5.1.2. Whether the proposed shareholding referred at Para 4.1.1 (A.5) and Para 4.1.1 (B.4), for foreign individuals / entities, should be brought down to 26% or 15%?
- 5.1.3. Any other suggestions / recommendations with respect to ownership and governance related proposals mentioned at Para 4 above?

Comments/ suggestions may be addressed to Shri Amit Kapoor, General Manager, Market Regulation Department and sent by email at amitk@sebi.gov.in or through post (address given below), latest by February 05, 2021, in the format below:

Details of respondent	
Name/ Organization	
Contact number	
Email address	

Comments on discussion paper			
Sr. No.	Changes proposed by SEBI	Comments/ Suggestions	Rationale

Kindly mention the subject of the communication as "Comments on *Discussion paper on Review of Ownership and Governance norms for facilitating new entrants to set up Stock Exchange/ Depository.*"

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