

## **Ad-hoc Expert Committee to Review Ownership and Economic Structure of Clearing Corporations - Chaired by Ms. Usha Thorat**

### **(I) Executive summary**

1. Given the substantial growth of Indian securities markets in recent years, the importance of clearing corporations as central risk management institutions cannot be overstated. In this regard, SEBI has formed an ad-hoc Committee under Ms. Usha Thorat, to review the ownership and economic structure of clearing corporations, and to suggest measures to ensure that clearing corporations function as resilient, independent, and neutral risk managers.

### **(II) Background**

1. The 2018 report of the Committee on review of regulations and relevant circulars pertaining to Market Infrastructure Institutions (MIIs), headed by Sh. R Gandhi (referred to as *Gandhi Committee*), had noted that the ownership of MIIs should be dispersed and should be widely held. With respect to clearing corporations, the committee has specifically noted that while most clearing corporations in India were 100% owned by a single exchange, given that clearing corporations are risk bearing MIIs, it is highly desirable that they should be widely held. Further, the Gandhi Committee had also noted that with the clearing corporations being sensitive and high risk-bearing and risk managing entities, listing of clearing corporations should not be permitted.
2. Subsequently, SEBI, vide its Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 has laid down norms for ownership and governance framework of CCs. The Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 (referred to as *SECC regulations, 2018*), *inter-alia*, lays down the following norms on shareholding in a recognised clearing corporation (Reg. 18):
  - a. At-least 51% of the paid-up equity share capital of a recognised clearing corporation to be held by one or more stock exchanges.
  - b. No person resident in India or outside India, other than stock exchanges, can hold more than 5% of the paid-up equity share capital in a CC.
  - c. Some other categories (depository, banking company, insurance company, their foreign counterparts including foreign stock exchange) can hold up to 15% of the paid-up equity share capital.
3. However, it is noted the current ownership structure of a clearing corporation is dominated by the parent exchange with all clearing corporations under regulatory purview of SEBI being subsidiaries of their parent exchanges. The dominance of the parent exchange in the ownership structure invariably exposes a clearing corporation to the expectations of shareholders of the parent exchange, with the financial statements of clearing corporations being incorporated in the consolidated financial statement of the parent exchange.

4. Moreover, the present norm of majority shareholding by the parent exchange in a clearing corporation makes it dependent on the parent exchange for capital infusion and augmentation of its reserves, including for any shortfall the corpus of its settlement guarantee fund. Infusion of capital in a clearing corporation by a parent exchange might be at odds with the economic interest of an exchange and its shareholders. The said situation is significantly compounded in a scenario where the parent exchange is a listed entity. There is a need to ensure that there is no scope nor any appearance of a perverse incentive that comes in the way of clearing corporations discharging their role as independent risk managers, crucial to the securities market ecosystem.
5. The securities market has also witnessed a structural change in recent times, with an exponential growth in derivatives, across the investor spectrum. Derivatives being leveraged products, invariably increase the tail risk in markets. Therefore, the need for resilience of a clearing corporation, especially in times of market stress cannot be overstated. The growth of market in recent years also means that the largest of market players and intermediaries have an implicit stake in resilience of a clearing corporation, i.e. ensuring that a clearing corporation is capitalized and capable of handling the inherent risk, which may be exacerbated during times of market stress
6. Additionally, with introduction of interoperability in certain segments, the clearing corporations cater to volumes from all the exchanges for the said interoperable segments. This is a case of a central common service, cutting across stock exchanges, being provided by the clearing corporations.
7. Also with respect to the finances of MIs, the Gandhi Committee, after deliberating on generating income and distribution of profits by MIs, had recommended that there should be no stipulation on the quantum of profits to be made by MIs but monitoring of reasonableness of the charges and fees levied by MIs should be preferred. Further, the committee also recommended that MIs should disclose the resources committed to strengthening regulatory functions.
8. The SECC regulations, 2018, *inter-alia*, lays down the following norms with respect to net-worth and settlement guarantee fund of clearing corporations.
  - a. Net-worth requirements (Reg. 14):
    - i. CCs to maintain capital to adequately cover counter party credit risk, business risk, legal and operational risk.
    - ii. CCs to hold additional capital to cover costs required for orderly wind-down or recovery of operations.
    - iii. CCs to maintain, at all times, minimum net-worth of INR 100 crs or as determined above, whichever is higher.

- b. Settlement guarantee fund (Reg. 37)
      - i. Every CC to have a fund to guarantee settlement of trades.
9. Furthermore, it may also be mentioned that the committee on Strengthening Governance of Market Infrastructure Institutions (Mahaligam Committee), vide its report dated November 02, 2022 had, *inter-alia*, also noted that since Market Infrastructure Institutions (MIIs) perform a dual role as a public infrastructure service provider with regulatory functions, and also as a profit-making corporate entity, it is important for the MII to ensure that adequate resources are deployed in the regulatory and risk as well as the operations and technology functions/departments of the MIIs.
10. Given the novation function of the clearing corporations, their role as central counterparties and as a first line regulator, the investment need for a clearing corporation towards enhancing capabilities in technology, settlement guarantee fund, human and regulatory resources cannot be overstated. Therefore, while clearing corporations can be considered as public utilities making reasonable profits to sustain their operations, the primary objective of all stakeholders should be that of ensuring market stability and development. Disbursing shareholder profits and capital appreciation should not be a consideration in the functioning of a clearing corporation.
11. Further, the recent measures being undertaken by SEBI towards enhancing market efficiency and investor protection, such as trading supported by blocked amount in secondary markets, shortening of settlement cycles and pay-in/pay-out validations, to name a few, require clearing corporations to make significant investments towards enhancing their technological infrastructure and processes.
12. With a substantial increase in trading volumes noted in recent years and growing interest amongst a wide category of investors, particularly in derivatives segment, clearing corporations would also have to augment their settlement guarantee funds.
13. In this regard, it has been observed that, the clearing corporations have been primarily dependent on the parent exchange for infusion of capital towards augmenting its settlement guarantee fund. The same would also apply when there is a need for substantial capital investments for investments required in technological infrastructure, risk management or human resources.
14. A case can then be made that the clearing corporations would need to function as a truly independent going concern, able to meet all its financial obligations and investment needs.
15. Globally, it is observed that some of the major clearing corporations such as DTCC and Euroclear have diversified shareholding while some other clearing

corporations such as LCH and SGX-DC are subsidiaries of the parent exchanges.

16. In view of the above, SEBI has set-up a committee under the leadership of Ms. Usha Thorat to examine these issues. The Terms of Reference (ToR) of the committee are as under:

### **(III) Terms of Reference**

#### **A. Ownership structure of a Clearing Corporation:**

- 1. *Given the current context, the committee may examine the current ownership norms of clearing corporations and suggest feasible alternative formulations that can ensure true independence of the clearing corporations' risk management and technology functions.***
2. *Towards the same the committee may, inter-alia, also deliberate on the following aspects:*
  - a. *Examining the feasibility and desirability of broadening the extant list of eligible investors which are allowed to take shareholding in a clearing corporation. Suggest categories of investors who can acquire shareholding in clearing corporations.*
  - b. *Examine the need for altering the caps on shareholding of various entities in a clearing corporation.*
  - c. *The suggested alternatives should keep in view the periodic capital needs of a clearing corporation towards augmenting its settlement guarantee fund.*
  - d. *The suggested alternatives should also keep in sight the need of a clearing corporation to ensure sufficient capital/ liquidity in times of market wide systemic stress.*
  - e. *Given the common service, cutting across exchanges that is provided by a clearing corporation in an interoperable environment, the committee can suggest shareholding pattern of clearing corporation suited to such an environment.*
  - f. *While suggesting the alternative ownership structures, the committee may also examine the shareholding structures of other clearing corporations globally and other relevant domestic peers such as CCIL, NPCI or such entities found suitable by the committee.*
  - g. *Any other associated matter considered relevant by the committee.*

B. Finances of a Clearing Corporation:

3. ***The committee is required to deliberate and suggest alternatives towards achieving optimum financial structure for a clearing corporation which ensures its financial independence and sustenance as a robust going concern, while also taking into consideration the following aspects.***
  - a. *The need for review of the current structure of levying of clearing charges/fees of various clearing corporations.*
  - b. *Sufficiency of revenue generated by clearing corporations.*
  - c. *Preparedness of clearing corporations to cover capital expenditure and investments.*
  - d. *Sufficiency of current and projected revenues of clearing corporations to meet the obligations on clearing corporations to maintain a minimum net-worth and maintaining the required settlement guarantee fund to cover market stresses.*
  - e. *Any other related matter considered relevant by the committee.*

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