

INTERNATIONAL FINANCIAL SERVICES CENTRES AUTHORITY

21st Authority Meeting held on 27.09.2024

Subject: International Financial Services Centres Authority (Market Infrastructure Institutions) (Amendment) Regulations, 2024

1. Introduction

1.1 IFSCA had notified the IFSCA (Market Infrastructure Institutions) Regulations in April 2021 (hereinafter referred to as “MII Regulations”). The MII Regulations provide a unified regulatory framework for MIIs such as the Stock Exchanges, Clearing Corporations and Depositories operating in an IFSC. The regulations, *inter-alia*, provide for:

- a) requirements for grant of recognition of MIIs*
- b) net worth requirements*
- c) shareholding requirements*
- d) fit and proper criteria for directors, shareholders and Key Management Personnel (KMP) of the MIIs*
- e) norms for corporate governance and code of conduct to be followed by MIIs*
- f) requirements for record keeping*

1.2 The norms on corporate governance in the MII Regulations require the MIIs to constitute their Governing Board in such a way that the number of Public Interest Directors greater than or equal to the number of Shareholder Directors. Further, they also mandate the appointment of the Chairman of the Governing Board from the Public Interest Directors.

1.3 The MII Regulations also require MIIs to follow the broader principles of governance prescribed under the Principles for Financial Market Infrastructures (PFMI) by the Committee on Payments and Market Infrastructures (CPMI) and International Organization of Securities Commissions (IOSCO).

1.4 IFSCA has mandated the constitution of various Committees by the MIIs for effective regulatory oversight on their functioning. Additionally, IFSCA has also specified the Code of Conduct for Directors and Key Management Personnel of the MIIs by way of a circular.

2. Proposal

2.1 The agenda note seeks the approval of the Authority to notify the International Financial Services Centres Authority (Market Infrastructure Institutions) (Amendment) Regulations, 2024.

3. Statement of Object and Reasons (SOR) for the proposed amendments

3.1 Over the past 3-4 years, the capital market in the IFSC have seen significant advancements, including the full-scale operationalization of the GIFT Connect and the announcement pertaining to direct listing for Indian companies on the Stock Exchanges in the IFSC. The daily turnover in the derivatives segment on the Stock Exchanges has witnessed rapid growth. The anticipated listing of equity shares in the near future is expected to boost volumes in the cash segment as well and broaden the category of market participants.

3.2 The MIIs, being profit oriented commercial entities, are vested with regulatory responsibilities. It is imperative that the MIIs, while pursuing their business objectives, do not lose sight of their regulatory duties. The MIIs are also the first line regulators for intermediaries such as Broker-Dealers, Clearing Members and Depository Participants. Due to the conflicting nature of this, it is felt that the governance standards of MIIs should be robust in order to enhance and maintain market confidence and deter malpractices. Corporate governance attains a higher significance in the IFSC context, where MIIs engage in cross-border arrangements.

3.3 Taking into consideration the growth in the transaction volumes in the past few years, the promising potential in the coming years and in line with the requirements of the IFSCA Regulations in relation to revision of IFSCA's regulations, the MII Regulations are proposed to be amended.

4. Benchmarking with International Best Practices

4.1 The objective of the proposed amendments is to strengthen corporate governance and oversight in the MIIs and enhance the transparency, accountability and investor/market confidence. The amendments to the MII Regulations have been proposed taking into consideration the principle relating to governance prescribed under the PFMI by CPMI and IOSCO.

4.2 Principal 2 of PFMI¹ related to Governance states as under:

An FMI should have governance arrangements that are clear and transparent, promote the safety and efficiency of the FMI, and support the stability of the broader financial system, other relevant public interest considerations, and the objectives of relevant stakeholders.

4.3 Additionally, the practices in global jurisdictions such as Singapore², Abu Dhabi Global Market³ and UK⁴ were also studied while proposing the amendments to the MII Regulations.

5. Consultation with Stakeholders and Outcome

5.1 The draft amendments to the MII Regulations have been proposed after taking into comments obtained from two public consultations (May 2024 and August 2024). In May 2024, comments were invited from the public and market participants as part of a review of the MII Regulations. Based on the comments received and considering the IOSCO-PFMI, IFSCA issued a [Consultation Paper](#) in August 2024 proposing the amendments to the MII Regulations.

5.2 IFSCA has received comments from the following entities:

- i. India International Exchange (IFSC) Limited
- ii. NSE IFSC Limited
- iii. NSE IFSC Clearing Corporation Limited
- iv. India International Clearing Corporation (IFSC) Limited
- v. India International Depository IFSC Limited
- vi. Institute of Company Secretaries of India

A compilation of the comments received along with our point wise response is attached at **Annexure - 1**.

6. Proposed amendments to the MII Regulations

¹ <https://www.bis.org/cpmi/publ/d101a.pdf>

² <https://sso.agc.gov.sg/SL/SFA2001-S608-2018?DocDate=20190614>

³ <https://en.adgm.thomsonreuters.com/rulebook/mir-232>

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[https://www.handbook.fca.org.uk/handbook/glossary/G631.html#:~:text=\(d\)%20a%20person%20who%2C.conduct%20of%20any%20relevant%20function.](https://www.handbook.fca.org.uk/handbook/glossary/G631.html#:~:text=(d)%20a%20person%20who%2C.conduct%20of%20any%20relevant%20function.)

6.1 To review the Corporate Governance requirements for MIIs, reference has been drawn to the report⁵ of the 'Committee on Strengthening Governance of Market Infrastructure Institutions', constituted by SEBI under the chairmanship of Shri G. Mahalingam. The key amendments proposed to the MII Regulations are as follows:

I. Change in the definition of KMP

In the comments received from the MIIs and the various ensuing discussions, it was suggested that the definition of KMP be amended to reflect the nascent stages of growth of the MIIs in IFSC. The current definition mandates that employees up to two levels below the Chief Executive Officer be identified as KMPs. Presently, the manpower deployed at the MIIs in IFSC is much lower than those deployed in a full-fledged, large MII (like in domestic India and overseas). Due to the lower employee count, the hierarchy in the MII used to be upto 2-3 levels below the MD & CEO. This often required the MIIs to designate junior level employees, who do not play any significant role in the management of the MIIs, as KMPs.

Therefore, the definition of KMP is proposed to be amended in such a way that it includes individuals:

- a) with the ability to influence decisions or
- b) those involved in the core functions

The core functions of an MII have been defined under Schedule-II of the proposed amendment Regulations. The definition of KMP has been proposed to be amended as under:

"key management personnel" includes:

- i. any person appointed as the managing director or executive director; or*
- ii. a person serving as the head of a department or vertical and directly reporting to the managing director or to the directors on the governing board of the recognised market infrastructure institution; or*
- iii. a person serving as the head of a core function as specified in regulation 27 of these regulations; or*
- iv. a person who stands higher in hierarchy to the head of any department(s) handling core function(s) in the recognised market infrastructure institution; or*
- v. a person to whom the key management personnel reports; or*
- vi. any person defined as "key managerial personnel" under the Companies Act, 2013; or*
- vii. any other person who is a key decision-making authority as identified by the governing board*

⁵ https://www.sebi.gov.in/reports-and-statistics/reports/nov-2022/strengthening-governance-of-market-infrastructure-institutions_64806.html

II. Segregation of functions of MIIs

One of the Key Consideration of Principle 2 of PFMI is that *“An FMI should have documented governance arrangements that provide clear and direct lines of responsibility and accountability. These arrangements should be disclosed to owners, relevant authorities, participants, and, at a more general level, the public.”*

Therefore, it is felt that a designated KMP should be assigned one or more specific core functions of an MII. This will ensure clear demarcation of functions and responsibilities. Accordingly, regulation 27 of the MII Regulations is proposed to be amended to mandate an MII to identify its core and critical functions and segregate them into verticals. The core and critical functions are required to be segregated into the following verticals:

a) Vertical 1: Critical Operations

- i. Provision and operation of trading facilities, clearing and settlement, and dematerialization of financial products including holding and transfer of such financial products;
- ii. Record keeping of information related to trade, clearing and settlement of trades and dematerialized financial products;
- iii. IT infrastructure for core and critical functions
- iv. Business continuity plan and disaster recovery functions
- v. Cyber security and cyber resilience framework

b) Vertical 2: Regulatory, Legal, Compliance, Risk Management and Investor Grievances

- i. Risk Management
- ii. Surveillance and Investigation
- iii. Listing
- iv. Registration of Broker-Dealer, Clearing Member or Depository Participant
- v. Admission of issuer or financial product
- vi. Legal
- vii. Compliance
- viii. Inspection
- ix. Enforcement
- x. Arbitration and Grievance Redressal Mechanism
- xi. Member Default
- xii. Investor Protection and Services

c) Other functions including business development

- i. Sales
- ii. Marketing
- iii. Product Development
- iv. Finance

III. Appointment of Directors

The extant MII regulations prescribe a maximum tenure of five years for the appointment of a Managing Director, subject to a maximum age limit of seventy years. Similarly, the Public Interest Director can be appointed for a term of three years extendable by another term of three years subject to the approval of the Authority.

The roles and responsibilities of the Managing Director of the MII, assumes great significance, given that the MIIs form the pillars of the capital market ecosystem. Therefore, in line with the need for periodic change, it is proposed that after each term, the appointment process for the Managing Director should be conducted afresh and the age limit for such a Managing Director be capped at sixty-five years. On similar lines, the age limit for a Public Interest Director may be capped at seventy-five years. It is also proposed that the Authority may appoint up to three persons as directors on the governing board of a recognised market infrastructure institution.

The term “shareholder director” is proposed to be replaced with the term “non-independent director” with the Managing Director being classified in the category of non-independent directors.

IV. Compensation for KMP

The provisions related to compensation policy for KMPs have been proposed to be included in the regulations. The compensation policy is to be laid down by the Nomination and Remuneration Committee after the approval of the Governing Board. With a view to strengthening the Corporate Governance practices of the MIIs and enhancing the accountability of the KMP, it is proposed that the compensation policy of the KMP include norms pertaining to malus and clawback arrangements.

V. Code of Conduct for the MIIs and its Governing Board, Directors, KMP, and Committee Members

IFSCA had prescribed the code of conduct and code of ethics by way of a circular dated September 13, 2021. In the proposed amendments, the code of conduct to be followed by the MIIs has been made part of the regulations.

The Key Considerations 3 and 6 of the principle 2 of PFMI state as under:

3. The roles and responsibilities of an FMI's board of directors (or equivalent) should be clearly specified, and there should be documented procedures for its functioning, including procedures to identify, address, and manage member conflicts of interest.

6. The board should establish a clear, documented risk-management framework that includes the FMI's risk-tolerance policy, assigns responsibilities and accountability for risk decisions, and addresses decision making in crises and emergencies. Governance arrangements should ensure that the risk-management and internal control functions

Accordingly, to ensure the transparency and accountability in the roles and duties of KMPs, the proposed code of conduct for the MIIs shall, *inter-alia*, include details on the segregation of roles and responsibilities of KMP such as:

- i. Clearly mapping legal and regulatory duties to the concerned position
- ii. Defining delegation of powers to each position
- iii. Assigning regulatory, risk management and compliance aspects to business and support teams

The extant MII Regulations specify principle-based requirements for risk management. In the proposed regulations, the Governing Board of an MII, has been entrusted with the following responsibilities with respect to risk management:

- i. The Governing Board of an MII shall play an active role in defining, establishing and documenting risk management framework, covering risk appetite or risk tolerance policy of the MII and ensure that the policy contains the following:-
 - a) role of risk appetite in key processes
 - b) clear quantitative metrics and thresholds to monitor performance of the market infrastructure institution's risk appetite
 - c) acceptability of breaches and trigger response(s), if any
 - d) zero tolerance for areas such as cyber security, system stability, surveillance, fair access, fraud or corruption, compliance, etc
- ii. The Governing Board of an MII shall ensure adequate independence of key functions such as regulatory and control functions (risk management, compliance and audit functions) such that;
 - a) regulatory and control functions have sufficient stature to perform their tasks effectively

- b) regulatory and control functions operate independently and have appropriate direct access to the Governing Board of the MII and senior management
 - c) control functions are proactively involved in all relevant decisions and activities
- iii. The Governing Board shall provide for three lines of defence construct where:
 - a) the first line of defence incorporates business units and support functions as it has the responsibility to own and manage risks associated with day to day operational activities.
 - b) the second line of defence consists of various oversight functions i.e., regulatory, risk management, compliance teams, and
 - c) the third line of defence comprises the internal audit function
- iv. The Governing Board of an MII shall ensure that the roles and responsibilities of the management in relation to these three lines of defence are clearly specified and understood and that all employees are responsible for the regulatory, risk management and compliance outcomes.

6.2 Additionally, the provisions with respect to mandatory appointment of a Chief Risk Officer (CRO) and a Chief Information Security Officer (CISO) are proposed to be included in the MII Regulations.

7. Expected Regulatory Impact

7.1 The objective of the amendments to the regulations is to strengthen the corporate governance practices within the MIIs in IFSC, thereby leading to greater transparency and accountability and higher market confidence. The amendments to the regulations propose to segregate the core and critical functions of the MII and assign the responsibilities of the same to a KMP to ensure the accountability of the KMP.

7.2 The responsibility of the Governing Board to ensure the independence of key functions such as regulatory, compliance and risk management is expected to strengthen the perception and role of the MIIs as Self-Regulatory Organizations (SROs).

8. Proposal to/ Decision sought from the Authority

8.1 The Approval of the Authority is sought for notifying the draft International Financial Services Centres Authority (Market Infrastructure Institutions) (Amendment)

Regulations, 2024 (**Annexure - 2**) in the Official Gazette, after carrying out changes, if any, of drafting and consequential nature. The Authority is further requested to authorize the Chairperson to make such necessary, consequential and incidental steps to operationalize these Regulations.
