

Exchanges

Regulatory fillip for competition in exchanges and depositories

SEBI has released a discussion paper (DP) titled 'Review of Ownership and Governance norms to facilitate new entrants to set up Stock Exchange / Depository'. The DP highlights the need for more competition among 'market infrastructure institutions (MIIs), namely exchanges and depositories, to improve overall efficiency and governance as well as to better adapt to new-age disruptive technologies. The DP proposes to address the issue with liberalisation of ownership framework for new entrants, at least in the initial stages.

- ▶ **DP points to business concentration in trading and depository space.** The regulator has expressed concern that Indian securities market is characterised by dominance in the trading and depository space, raising concerns on possibility of excessive concentration and institutional tardiness in response to the changing market dynamics, which may adversely impact efficiency in trading, record-keeping, supervision and risk management.
- ▶ **DP underlines need for MIIs to adapt to new disruptive technologies, hence be able to counter the threat of business concentration.** One dominant trend shaping the exchange and depository landscape is the emergence of new technologies such as distributed ledger technology, artificial intelligence, machine learning, etc. Several new fintech players have emerged in the trading space in various international jurisdictions, who are increasingly deploying these disruptive technologies and challenging the traditional functioning of stock exchanges and depositories (market infrastructure institutions, or MIIs). It is therefore necessary to forge a competitive landscape in the MII space by facilitating new players, who may challenge other MIIs in their already established domains, to set up MIIs, or merge with or acquire, the existing entities.
- ▶ **DP proposes a liberalised initial ownership framework.** The current framework appears to inhibit entry of new players, or acquisition of existing entities, due to a precondition of dispersed shareholding at the initial stage itself, which limits the upside gains for a potential entrant. The DP therefore proposes to create a liberalised ownership framework by allowing higher shareholding at initial / inception stages with dilution over a period of time. The Internal Working Group (IWG) set up by SEBI has observed that there exists a liberal framework on ownership and governance both in major international jurisdictions as well as in banking and insurance sectors in India vis-à-vis those for MIIs in Indian securities market.
- ▶ **Blockchain has been mentioned in the DP:** The distributed ledger technology (blockchain) has potential to disrupt any institution engaged in centralised aggregation of trading orders (stock exchange) or as centralised ledger keeper (depository). New developments / experiments are taking place in this arena across various jurisdictions such as the US, UK, Australia, etc. For instance, the London Stock Exchange Group (LSEG) in UK and NASDAQ in US are deploying the blockchain technology to overhaul their trading processes and supervisory mechanisms.

Research Analysts:

Ansuman Deb

ansuman.deb@icicisecurities.com
+91 22 6637 7312

Ravin Kurwa

ravin.kurwa@icicisecurities.com
+91 22 2277 7653

- ▶ **Interoperability should also help new entrants:** Operationalisation 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).

Proposed liberalised framework for MII ownership

For setting up of a new MII

- Resident promoter setting up the MII may hold up to 100% shareholding, which shall be brought down to not more than (51% or 26%) in 10 years.
- A foreign promoter (from FATF member jurisdictions) setting up the MII may hold up to 49% shareholding (in terms of consolidated FDI circular, 2020), which shall be brought down to not more than (26% or 15%) in 10 years.
- Foreign individuals / entities from other than FATF member jurisdictions, may acquire or hold up to 10% shareholding in a MII.
- Any person (domestic or foreign), other than the promoter, may acquire or hold less than 25% shareholding.
- At least 50% of ownership of the said MII shall be represented by individuals / entities having experience (five years or more) in areas of capital markets, or technology related to financial services.

For an existing MII

- A person may directly or indirectly, either individually or with persons acting in concert, may acquire or hold up to 100% shareholding in a MII, which shall be brought down to not more than (51% or 26%) in 10 years provided that any acquisition of 25% or more shall be subject to prior approval of SEBI and compliance with provisions of SEBI takeover regulations (in case of both listed or unlisted MIIs).
- A foreign promoter (from FATF member jurisdictions) may hold up to 49% shareholding (in terms of consolidated FDI Circular, 2020), which shall be brought down to not more than (26% or 15%) in 10 years provided that any acquisition of 25% or more shall be subject to prior approval of SEBI and compliance with provisions of SEBI takeover regulations (in case of both listed or unlisted MIIs).
- Foreign individuals / entities from other than FATF member jurisdictions, may acquire or hold up to 10% in a MII.

Prior approval of SEBI shall be mandatory for acquisitions exceeding 10%, in case of both setting up of a new MII or an existing MII.

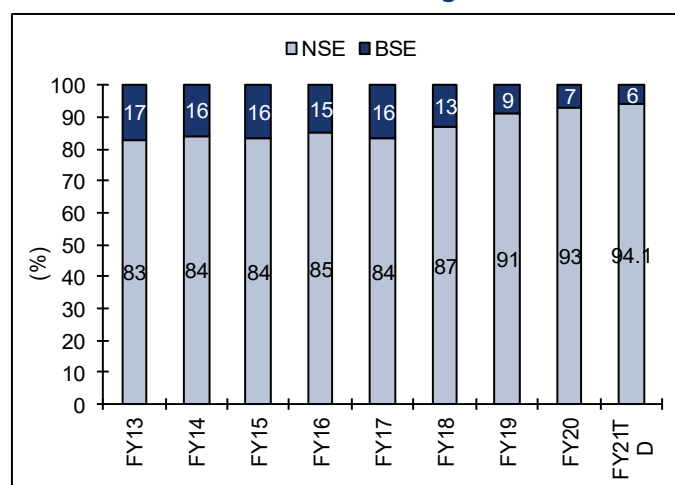
Proposed changes in governance requirements

Diversification in the composition of statutory committees at MIs to have wider representation of stakeholders:

- Grievance Redressal Committee – to include a Public Interest Director
- Nomination and Remuneration Committee – to include Shareholder Directors (SHDs) and MD & CEO as permanent invitees.
- Standing Committee on Technology – to include MD & CEO, and CTO as permanent invitees.
- Regulatory Oversight Committee – to include SHDs (including MD & CEO).
- Risk Management Committee – to include a SHDs (including MD & CEO).

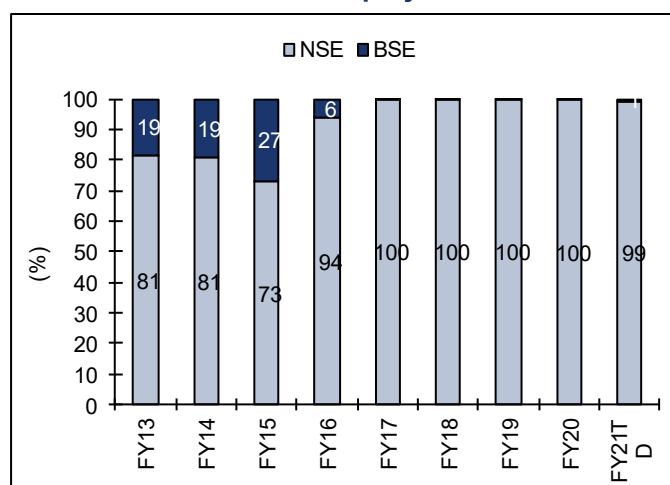
The appointment of MD & CEO shall be for a maximum of three terms of three years each instead of two terms of up to five years each.

Chart 1: Market share in cash segment



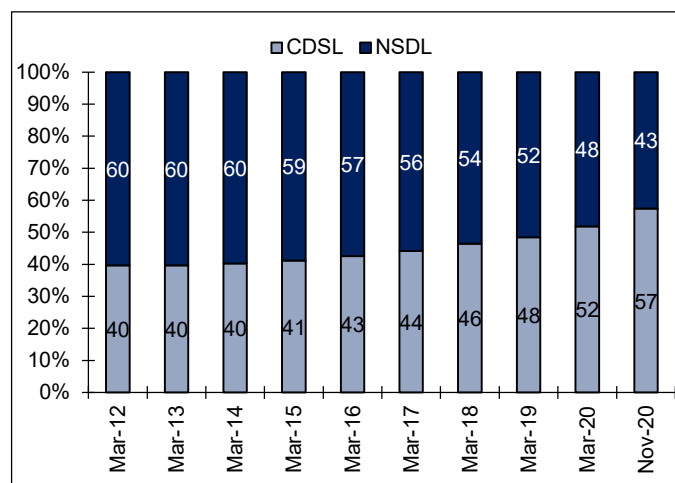
Source: NSE, BSE

Chart 2: Market share in equity derivatives



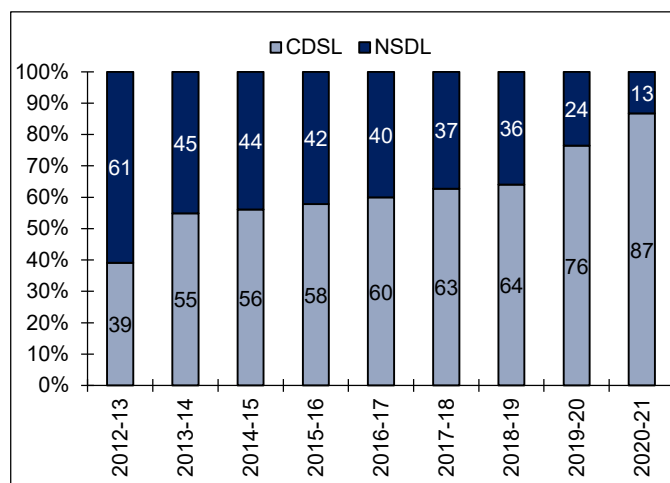
Source: NSE, BSE

Chart 3: Number of demat market share

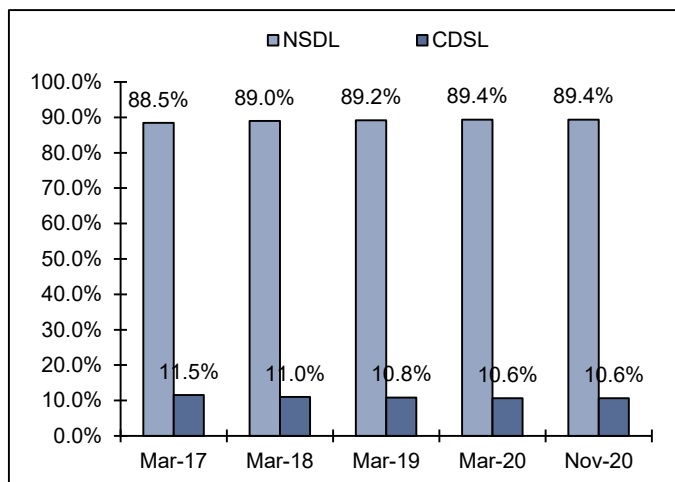


Source: NSE, BSE

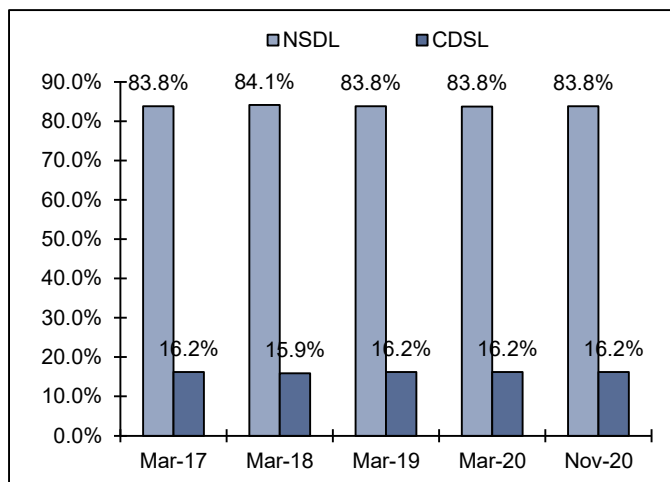
Chart 4: Incremental market share trend



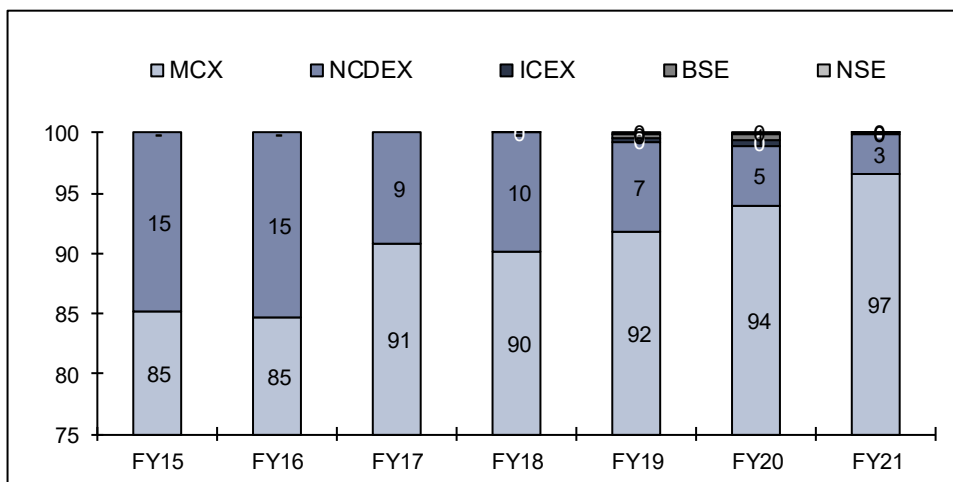
Source: NSE, BSE

Chart 5: Demat value market share

Source: CDSL and NSDL

Chart 6: Demat quantity market share

Source: CDSL and NSDL

Chart 7: Commodity market share trend

Source: MCX, NCDEX, NSE, BSE

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