

Consultation paper on “Process for appointment of specific KMPs of an MII; and cooling-off period for KMPs and Directors of an MII joining a competing MII”

A. Process for appointment of KMPs of Verticals 1 and 2 of an MII, viz., Compliance Officer (CO), Chief Risk Officer (CRiO), Chief Technology Officer (CTO) and Chief Information Security Officer (CISO) or by whatever designations referred.

Objective

1. To strengthen the governance framework of Stock Exchanges, Clearing Corporations and Depositories (collectively referred as Market Infrastructure Institutions (MIIs)) by ensuring that MIIs are staffed by Key Management Personnel (KMPs) of appropriate stature and independence in the crucial areas of compliance, risk, technology and information security. These KMPs (namely the CO, CRiO, CTO and CISO) are crucial for any MII to deliver on its core public interest mandate of giving primacy to technological resilience, market integrity, and compliance, over commercial considerations.

Background

2. MIIs are institutions that provide vital capital market infrastructure for trading, clearing & settlement, and holding, transfer, & record keeping of securities. They have a unique operating model in that they are empowered by law to regulate their own paying members such as listed corporates, Trading Members, Clearing Members, and Depository Participants. They are required to primarily focus on serving as crucial public utilities for capital markets and as first line regulators, while also operating as efficient, innovative, and competitive commercial profit-making entities.
3. Specifically, the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 (SECC Regulations, 2018) and Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018 (D&P Regulations, 2018), require MIIs to give higher priority to Critical Operations (Vertical 1, covering operations and technology),

and Regulatory, Compliance, Risk Management and Investor Grievances (Vertical 2) over other functions including Business Development (Vertical 3).

4. To ensure this prioritization, MIIs have a Governing Board that must have an equal or majority of non-executive Public Interest Directors (PIDs) over other directors. SEBI selects and approves appointment of PIDs from amongst the candidates suggested by the Governing Board of the MII. SEBI also selects and approves the appointment of the Managing Director (MD) of the MII, from amongst the candidates suggested by the Governing Board of the MII. MIIs are also subject to regulatory oversight by SEBI.
5. The appointment and removal of other KMPs (including the CO, CRiO, CTO and CISO, who are collectively referred to as Vertical 1 and 2 KMPs) currently come under the purview of the NRC of the MII.
6. Note that the larger MIIs currently enjoy high operating margins with Profit Before Tax to Income margins of 60% or more, high equity price to earnings multiples, and significant dividend pay-out ratios.

Need for Review

7. While the Governing Board of the MII sets the tone at the top, the culture of giving primacy to public interest (Verticals 1 and 2) over commercial interest (Vertical 3) must run deep at the operating level as well. Note that the MD has overall authority and responsibility over all three Verticals (1, 2, and 3).
8. Along with having a capable MD, there is a need for able KMPs of appropriate stature and ability in Vertical 1 and 2. These KMPs, in particular, are responsible for ensuring appropriate Compliance Standards, Risk Management, Technology Infrastructure, and Information Security at the MII, while not being constrained by considerations of Vertical 3. These KMPs must be able and willing, and be seen to be able and willing, to operate independent of short-term commercial considerations of Vertical 3 as necessary, to ensure

that the MII delivers its primary mandate as a public utility infrastructure institution and as a first line regulator.

9. It has been observed that in certain large MIIs, there is a significantly large gap between the compensation of the MD and the KMPs heading Verticals 1 and 2 of the MII. These KMPs also report to the MD. (Note that SEBI is in the process of requiring these KMPs to independently interact with the appropriate Statutory Committees of the Governing Board, which would also in turn additionally contribute to their annual performance appraisals.)

Proposals

10. In order to reinforce the important role of CO, CRiO, CTO and CISO (by whatever name called) in carrying out their obligations in public interest, without being influenced by commercial considerations, it is proposed that the process for appointment, reappointment and termination of service of such specific KMPs of Vertical 1 and 2 of an MII may be subject to the following:

For Appointment

- 10.1. As with the appointment of MD, MII shall engage an independent external agency (“the Agency”) to identify and recommend suitable candidates for appointment as KMPs in charge of Verticals 1 and 2 of the MII, viz. CO, CRiO, CTO and CISO by whatever designations called.
- 10.2. The Agency shall submit its recommendations to the Nomination and Remuneration Committee (NRC) of the MII.
- 10.3. The NRC will evaluate the recommendations of the agency, and submit its own recommendations to the Governing Board of the MII and SEBI simultaneously.
- 10.4. SEBI will review the NRC’s recommendations and will provide comments, if any, for the consideration of the governing board of the MII in a time bound manner. If no comments received from SEBI in the prescribed period, then

the Governing Board of the MII shall assume that SEBI has no comments to offer.

10.5. The Governing Board shall make the final decision for appointment after considering NRC's recommendations and SEBI's comments, if any.

For Re-appointment and Termination

10.6. The NRC shall evaluate the cases of reappointment/ termination and submit its recommendations to the Governing Board of the MII and SEBI simultaneously.

10.7. SEBI will review the NRC's recommendations and will provide its comments, if any, to the Governing Board of the MII in a time bound manner. If no comments received from SEBI in the prescribed period, then Governing Board of MII shall assume that SEBI has no comments to offer.

10.8. The Governing Board shall make the final decision for reappointment/ termination after considering NRC's recommendations and SEBI's comments, if any.

11. The above process can further facilitate and institutionalize appropriate independent focus on the core public utility mandate of the MII, and ensure that persons of appropriate stature and standing are appointed as KMPs of Verticals 1 and 2.

B. Uniform regulatory treatment of minimum cooling-off period for KMPs and Directors of an MII before they join a competing MII

Objective

1. To empower the Governing Board of an MII to set the policy around minimum cooling-off period for its KMPs and Directors on the Governing Board, before they can join a competing MII.

Background

2. Whereas no cooling-off period is prescribed for MD and KMPs under extant regulations, there is provision for cooling-off period for PIDs as prescribed under Regulation 24(3) of SECC Regulations, 2018 as under:

“Public interest directors shall be appointed for a term of three years, extendable by another term of three years, subject to performance review in the manner as may be specified by the Board:

Provided that post the expiry of term(s) at the recognized stock exchange or the recognized clearing corporation, a public interest director may be appointed with the prior approval of for a further term of three years in other recognized clearing corporation or recognized stock exchange, or a depository, only after a cooling-off period of one year”

3. Similar provisions as stated at paragraphs 2 & 3 above are also applicable to depositories under D&P Regulations, 2018.
4. While regulations do not prescribe any cooling-off period for the MD and other KMPs, MIIs do individually stipulate cooling-off period in their employment contracts. An Expert Working Group (EWG) that reviewed the PID framework also considered whether a cooling-off period should be mandated under regulations for the MII MD, akin to the cooling-off period for PIDs. The EWG recommended against introduction of such a regulatory cooling-off period, and suggested that this should continue to be left to the Governing Board of the respective MII to determine.

Need for Review

5. While regulations specify a minimum cooling off period for PIDs to move to other MIIs, there is none mandated for the MD, other Directors, and other KMPs. This anomaly may need to be addressed.

Proposal

6. In view of the above, it is proposed that MII shall adopt and implement a policy approved by its governing board prescribing a minimum cooling-off period for KMPs (including the MD) and their Directors (including PIDs) before joining a competing MII. SEBI shall no longer prescribe a cooling-off period for PIDs of an MII joining another MII.

Explanation: For the purpose of this proposal, the term “competing MII” refers to movement from one exchange to another exchange, one Clearing Corporation to another Clearing Corporation and one Depository to another Depository.

Public Comments

1. Comments of the public are invited on the proposals at paragraphs A(10) and B(6) above.
2. The comments/ suggestions maybe submitted latest by December 12, 2024 through web based online mode at the following link

<https://www.sebi.gov.in/sebiweb/publiccommentv2/PublicCommentAction.do?doPublicComments=yes>

3. In case of any technical issue in submitting your comment(s) through the web based public comments form, you may email your comment(s) to pankajc@sebi.gov.in. While sending the email, kindly mention the subject as **“Process for appointment of specific KMPs of an MII; and cooling-off period for KMPs and Directors of an MII joining a competing MII”**

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