

EXTRACT OF MINUTES OF THE 199th MEETING OF THE BOARD OF DIRECTORS OF NATIONAL STOCK EXCHANGE OF INDIA LIMITED HELD ON WEDNESDAY, NOVEMBER 01, 2023, FROM 12.00 NOON TO 6.05 P.M. AT THE CONFERENCE ROOM, GROUND FLOOR, 'A' WING, EXCHANGE PLAZA, BANDRA-KURLA COMPLEX, BANDRA (EAST), MUMBAI- 400 051.

To consider and approve relevant changes in Chapter XII and Chapter XIII of the Exchange Byelaws post SEBI circular dated May 30,2023

The Board was informed that SEBI had issued guidelines vide SEBI circular SEBI/HO/MRD/MRDPoD- 3/P/C/R/2023/81 dated May 30,2023 on Comprehensive guidelines for Investor Protection Fund and Investor Services Fund at Stock Exchanges and Depositories and that the Exchange is required to make necessary amendments to the relevant byelaws, rules and regulations for the implementation of the above circulars. Also, relevant modification is required in Chapter XII and XIII of Exchange Byelaws based on certain SAT matters and recommendations received from MCSGFC.

The Board was further informed that the said circular issued comprehensive guidelines on maintaining the IPF at Stock Exchanges which have been modified by SEBI from time to time through various circulars. The circular also advised the Exchange to make relevant changes in the Byelaws. The below Paragraphs of the said circular are required to be updated in Chapter XII and Chapter XIII of the Exchange Byelaws.

1. Para no. B - Contribution to IPF of Stock Exchange
2. Para no. F- Review of IPF Corpus
3. Para no. H - Manner of inviting claims from investors by stock exchanges
4. Para no. I - Eligible claims
5. Para no. J - Threshold limit for claims
6. Para no. K - Determination of claims from IPF for clients of the defaulter TM
7. Para no. L - Disbursement of claims from IPF

The Board was further informed that apart from the above circular, the MCSGFC vide meeting dated March 22, 2023 and October 03, 2023 had advised the Exchange to update the Exchange policy and Byelaws based on few SAT matters. Provision was required to be done in the Byelaws where the Claimant has been cheated by the TM/AP and consequently the Claimant initiated proceedings (Civil/Criminal) against the TM/AP before any forum and an order is passed against the TM/AP by a competent Court not below the High Court, in favour of the investor. Also, provision is required to be made with respect to trades done post demise of the investor.

The above changes in Chapter XII and Chapter XIII of the Exchange Byelaws post SEBI circular dated May 30,2023 have been discussed in the MCSGFC meeting dated March 22,2023, October 03,2023 and in ROC at its meeting dated August 22,2023. MCSGFC & ROC have recommended the same to the Board for its approval.

The Board after discussions considered and approved the amendments.

Consideration and approval of sizing of Default Cover for NCL along with validation report.

The Board was informed that the matter was presented to the Risk Management Committee at its meeting held on July 10, 2023 and to the Board at its meeting held on July 27, 2023. The Board and RMC during the said meetings were apprised that an exercise was undertaken to identify extreme but plausible scenarios and the scenario of a 25% fall in market coupled with 25% year-on-year increase in OI over the next 3 years was considered, which results in a Default Cover estimation of approx. INR 16,000 crores.

The Board while reviewing the proposal suggested that a validation of the assumptions was required to be done by an independent expert and the outcome of the same needs to be presented in a joint meeting of Risk Management Committee (RMC) & Group Investment Committee (GIC), which will review the same and recommend to the Board the additional contribution to be made towards core SGF.

The Board was informed that an external expert was appointed as an independent expert to validate the assumptions and outcome of the above-mentioned proposal.

The external expert made a brief presentation to the Board, the highlights of which were as below:

- While the PFMI and IOSCO principles suggest that CCPs should maintain default cover for top 2 Clearing Member defaults, evidence suggests that the role of Clearing Members beyond top 2 is rising, so if the OI continues to rise Cover 2 may prove inadequate.
- Further, there are some non-quantifiable factors that could also impact default cover such as: i) network/contagion effects, ii) crowded trades, iii) CMs participation in multiple CCPs, and iv) liquidation costs.
- Given the increasing role of CMs beyond the top 2 CMs and net impact from other non-quantifiable factors, it is recommended to use a 'factor of safety' buffer. The factor of safety maybe in the range of 25% to 50%, as deemed fit. The median ratio of losses of top 4 as compared to top 2 CMs works out to 1.35 and for the purpose of this review and for determining the size of the default fund, the factor of safety is set at 25% on top of MRC/Cover 2 losses.
- Further, in order to estimate the default cover, a distribution of OI projection has been considered instead of a point estimate and a polynomial model has been used to arrive at the distribution of cover 2 losses. Using this approach, 25th and 75th percentiles of projected stress losses come out to be INR 8,219 crores and INR 20,899 crores respectively.
- Incorporating a factor of safety of 25%, the review estimates the projected stress losses in the range of INR 11,000 crores and INR 25,000 crores, with a median value of INR 16,000 crores.

- It is a coincidence that the median value of stress losses from this review matches the estimate originally provided by NCL, but as the review concludes, the specifics of the analysis used in the review are very different.
- Adequacy of the Cover 2 standard merits further analysis, and until the time more evidence is available, use of a factor of safety in sizing the default fund is highly recommended. The median level of estimated stress losses of INR 16,000 crores includes an adjustment of a factor of safety of 25%.

The same was also discussed at the joint meeting of the Risk Management Committee (RMC) and Group Investment Committee that was held on October 23, 2023. The RMC and GIC approved and recommended that the corpus of the Core SGF could be augmented to INR 10,000 crores over a period of time.

The Board was also updated regarding a recent order passed by ITAT with respect to contribution towards Core SGF by NSE for AY 2016-17. The Board was apprised that the Tribunal while considering the matter and passing the order has specifically taken on record the fact that it was a statutory contribution made by the exchange as per SEBI guidelines / circular. The Board was further informed that potentially, this was one of the critical aspect while deciding the matter in favor of the exchange. Considering this, the Board desired that a written communication / advisory be obtained from SEBI in the form of a circular/ notification / letter, etc as we are in the process of augmenting the corpus of Core SGF from INR 5000 crore to INR 10,000 crores so that it becomes seamless to claim it as an allowable business expenditure under the Income Tax in line with the findings of the Tribunal as the same has potential tax impact of around INR 1200 crores going forward.

The Board members advised that;

- Contribution of INR 500 crores per quarter for the remainder of the year to be made, subject to SEBI instructions, to increase the corpus of Core SGF to INR 10,000 crores, in aggregate, including contribution made by NCL and the possibility of using insurance.
- Insurance cover quantum, costs, etc, to be evaluated and discussed subsequently once the details are available.
- Obtain instruction / letter / circular, etc., from SEBI so that there are no tax deduction issues on contribution to Core SGF going forward.
- To evaluate using risk capital for contributing towards core SGF.

The Board decided to contribute INR 500 crores in the remaining two quarters of FY 23-24 besides the contribution of INR 500 crores already made for September 2023 quarter on adhoc basis. However, the same is subject to obtaining either a circular, letter or instruction from SEBI. Post the year end, the same may be reviewed and necessary modifications may be made considering the insurance amount and other factors.

To take note of resolutions passed through circulation.

The board took note of the following resolutions passed through circulation.

Consideration and approval for interim contribution to Core SGF of NCL

SEBI vide its circular, bearing reference number CIR/MRD/DRMNP/25/2014, dated August 27, 2014, had, inter alia, laid down key principles, framework/methodology etc. surrounding the computation, contribution and utilisation/administration of the Core SGF etc. As per the said SEBI framework, currently, there are three contributors to the core SGF i.e. NSE being 25%, NCL being 50% and Clearing Members (CMs) being 25% (including TM/CM). While the framework stipulates 25% by the CMs (including TM/CM), SEBI, vide a separate directive had advised the Exchange to also pick up the 25% share pertaining to the TM / CM. Accordingly, at present, there are two contributors to the Core SGF (namely, 50% by the Exchange and another 50% by the Clearing corporation). Also, the current methodology to compute the core SGF requirement is to look at a scenario wherein maximum loss of top two-member defaults in a particular segment is considered as the minimum required corpus.

The above-mentioned SEBI framework broadly considers default situations in extreme but plausible market conditions in terms of both defaulter's positions and price change with 20% market movement affecting top two members. Further, as on August 31, 2023, the total Core SGF stood at Rs. 5,308.59 Crores, this amount is across all the segments. The Board may recall that in its 198th meeting held on July 27, 2023, the Board was informed that the Core Settlement Guarantee Fund (Core SGF) maintained by NCL as on June 30, 2023, stood at Rs. 3,931 Crores in FO segment.

The Board was briefed that there was a need to size the quantum of Default Cover (Core SGF + default insurance) that may be required based on potentially extreme but possible hypothetical movements over a 2–3-day horizon combined with estimated growth in Open Interest (OI) over the next 3 years. In past few years the overall trading activities in the market have significantly increased. Further, while the current risk management policies/systems/practices including the regulatory framework etc. at NSE/NCL are significantly robust, funding for risk capital more specifically in the form of Core SGF is a continuous area of focus.

The Board in its meeting held on May 15, 2023, had considered augmenting the Core SGF with NSE's contribution of Rs. 1,500 crores in FY 2023-24. This was in addition to the transfer of 2% of transaction charges levied by the Exchange (approx. Rs. 200 crores+ for FY 2023-24). Thereafter, an exercise was undertaken to identify plausible scenarios and the scenario of a 25% fall in market coupled with 25% increase in OI over the next 3 years along with certain assumptions.

This resulted in a Default Cover requirement estimation of approx. Rs. 16,184 crores for F&O segment. The Board was apprised of the methodology by which this default cover would be built up over the next 3 years.

This matter was also placed before the Risk Management Committee of NSE (RMC) in its meeting held on July 10, 2023, wherein RMC made the following suggestions –

- i. The roadmap and scenario suggested needs to be reviewed on an annual basis.
- ii. In order to look at the market impact, an analysis needs to be done on days when the markets have fallen even with minimal FII flows due to limited buying interest and other factors that can contribute to market falls.
- iii. With respect to the assumption on member's contribution, RMC suggested that it is better to assume the same starting from year 2026 only and appropriately increase the default insurance amounts in 2024 and 2025 if possible.
- iv. With respect to default insurance, RMC suggested to explore changing the waterfall mechanism (i.e., payout from SGF first and then insurance subsequently) in order to reduce the insurance premium and also to have the flexibility. RMC also suggested to have a step-up structure for the premium instead of discrete quantified amounts.
- v. RMC also suggested to explore consultations with other clearing corporations and if relevant, some custodians in order to see how they size their settlement guarantee fund.

Additionally, the Board in its meeting held on July 27, 2023, also decided that an amount of Rs. 1,400 Crores be transferred in the current year to NSE Clearing Limited (NCL), as capital infusion, subject to SEBI approval, which NCL would in turn contribute towards NCL's share of core SGF.

Also, w.r.t ongoing core SGF contribution, the Board had suggested that a validation of the assumptions of 25% market fall coupled with 25% CAGR growth in OI for the next 3 years needs to be done by an Independent Expert and the outcome of the same needs to be presented in a joint meeting of Risk Management Committee (RMC) & Group Investment Committee (GIC), which will review the same and recommend to the Board the amount of additional contribution to be made towards core SGF. The Board advised that this study be performed expeditiously so that any contribution to be made to the Core SGF could be made by September 2023. The amount so derived and recommended by RMC & GIC as contribution for FY2023-24 would be then transferred to Core SGF in tranches over the remainder of the year.

The study to validate the assumptions and estimates as advised by the Board has already been initiated with Prof. Virmani from IIM Ahmedabad and the report of the study would be placed at a joint meeting of the RMC and GIC to be held in due course and the outcome and recommendation of the said joint meeting, would thereafter be placed before the Audit Committee and the Board.

The Board may kindly recall that the Statutory Auditors were of the view that in order to be able to account the said contribution to the Core SGF as an expense by NSE, an actual payment to NCL Core SGF would be necessary.

Since the study by External expert is expected to take a while, in the interim, it is proposed that as per the discussions at the previous Board meetings, the above estimated amount Rs. 1,500 Crores be considered as NSE's contribution up to March 2024. Also, this amount could be reviewed post the completion of the study. However, for the closure of the books of account for the quarter ending September 30, 2023, an amount of Rs. 500 Crores be transferred to NCL Core SGF (i.e. Rs. 1500 Crores spread over three quarters (July 23 to March 24). The difference, if any, based on the study report, would be rebalanced / adjusted, as necessary, in the next two quarters of the current financial year.

The Board approved an interim adhoc contribution of Rs. 500 Crores towards NSE Clearing Limited - Core Settlement Guarantee Fund (NCL Core SGF) on September 30, 2023.