

NSE Responses to the Guideline document issued by PNGRB on 10 July 2020.

Regulation Specific Observations

1. Regulation 5(Approval and Suspension of the Contracts by the Board): Innovation is the key for the success of the proposed Gas Exchange. Innovative products that fill gaps in the product portfolio and address the needs of the market participants could help build liquid market for natural gas products in India. Therefore, it is critical that the new product approval process while going through appropriate vetting by the Regulator, needs to take into consideration speed with which product introductions could happen to meet the market need.

In view of the above, it is suggested that appropriate turn-around times be built into the Regulatory framework. Also it is critical that Gas Exchanges / market are clearly provided with reasons for considering / not considering specific products so as to bring clarity to the whole process.

2. Regulation 6(2) c. iv.-Qualification Test- the Regulations lay down that the Board may direct a gas exchange to introduce qualification test for personnel handling electronic trading terminals and trading in natural gas however it does not specify whether it would be for people deployed by the exchange or would this for the trading members of the exchange. For example, trading members of stock exchanges have to obtain NISM/NCFM certification for registering themselves.
3. Regulation 11(4) (Setting up of Clearing Corporation): Clearing Corporation (CC) performs three primary functions as a financial intermediary in any Trading Transaction: clearing, settlement and risk management. As part of the process, the CC as a counterparty to both sellers and buyers, collecting money from each, which allows it to guarantee the terms of a trade. The primary objective of any clearing corporation is:
 - to bring and sustain confidence in clearing and settlement of securities;
 - to promote and maintain, short and consistent settlement cycles;
 - to provide counter-party risk guarantee, and
 - to operate a tight risk containment system.

Since setting up of a clearing corporation involves additional capital in the form of minimum capital required, we would like to make the following submissions:

- The objectives of the CC, in the initial years, shall be managed by the exchange and the exchange shall ensure all the key functions of CC are performed by it ranging from collection of margins to settlement of the underlying product.
 - Once a Contract is matched, and accepted, the Gas Exchange shall be substituted as deemed central counter party for all financial liabilities of the Members or the Clients, as applicable in specified Contracts in which the Exchange decides to accept the responsibility of guaranteeing the financial obligations under such Contracts;
 - The need for settlement guarantee should be linked to the business model proposed by the exchange and in the absence of the CC, the exchange shall

maintain the fund for settlement of defaults of its Members and may comprise of various deposits of Members or any sources of funds as may be stipulated by the Exchange from time to time

- NSE, presently the largest derivatives exchange in the world, started its operations with the Clearing functions managed under the Exchange umbrella before setting up CC in 1998-1999 four years post the inception of the Exchange.
- Energy Exchanges (IEX & PXIL) approved and regulated by Central Electricity Regulatory Commission (CERC) have been operating since 2008 without a Clearing Corporation.
- Since the volumes will not be significant in the initial years, Exchanges should be given a time frame of 5 years to establish a CC as per the guidelines.

4. Regulation 20(a)(Shareholding Pattern) : The current guideline stipulates the following:

- a. No member of an authorised gas exchange, shall at any time, directly or indirectly, either individually or together with persons acting in concert, acquire or hold more than five (5) per cent of the paid-up equity share capital in an authorised gas exchange.
- b. At no time all the members of an authorised gas exchange shall in aggregate, directly or indirectly through associates, together with persons acting in concert for any of them, acquire or hold more than forty-nine (49) per cent of the paid-up equity share capital in an authorised gas exchange.
- c. No person, other than a member of an authorised gas exchange, shall at any time, directly or indirectly, either individually or together with persons acting in concert, acquire or hold more than fifteen (15) per cent of the paid-up equity share capital in an authorised gas exchange.

Provided that the persons, other than members of an authorised gas exchange and promoters of the gas exchange may hold more than 15 % of the paid up equity share capital of the gas exchange. However, they would be required to divest shareholding in excess of 15% within 5 years of authorization of gas exchange.

Success of the proposed exchange depends on the strategic partners who would contribute to operationalising best in class products and processes. Some of the proposed strategic partners are large institutions in the gas market ecosystem and are crucial for the success of the Gas Exchange. Some of these institutions would also become trading and / or clearing members of the Gas Exchange.

NSE envisages to get a set of such strategic partners for the business to leverage their expertise in the gas market ecosystem. Therefore, it is suggested a that proviso as given below may be inserted with point 'a' above:

That trading and / or clearing members who are Central PSUs or promoted by PSUs or State Government PSUs may be allowed to hold more than 5% of the paid up equity of the proposed Gas Exchange for a period of 5 years from the date of notification of the final regulations by PNGRB.

The reasons for the propose enhancement to the guideline are as follows:

- The first wave of demutualisation began in the early 90's and was followed by a second stage in which exchanges became publicly traded. Under this new model, non-brokers could be owners and revenues of the new exchanges were now driven primarily by fees for a range of activities, including trading, listing, clearing, settlement, depository, custody services followed by revenue streams of market data, analytics or information fees. However, the proposed Gas Exchange framework being more of Institutional market, the revenue model may not be as promising as a regular stock exchanges which caters to all categories of Investors with varied services under its offerings.
- Since the proposed business model of gas exchange is new to the market, the gestation period for market development would be slightly longer and hence significant commitment would be required from long-term investors both in terms of acquiring a stake and also from the perspective of their term of holding.

It is also suggested that Regulation 20(a) (Shareholding pattern) be stated in a way that prevents misinterpretation.

5. Regulation 22(2) B. iv. provides *that an order, restraining, prohibiting or debarring the person or any of its directors has been passed by the Board or any other regulatory authority and a period of three years from the date of the expiry of the period specified n the order has not elapsed*– however the draft Regulation do not specify the nature of restrictions imposed, that would lead to applicability of this regulation. For instance the SECC lays down restrictions in terms of accessing securities market. Something of similar nature may be considered here for the purpose of this regulations as it would remove the ambiguity.
6. Regulations 24(1) b. provides for independent directors however the SEBI framework provides for Public Interest Directors since exchanges have accountability towards the Public. The same may be considered for the purpose of the gas exchange as well.
7. Regulation 26(4): We would like to submit that in our experience of setting up market infrastructure across various asset classes, over the last two and half decades we have been able to bring wide participation and deep liquidity in equities, equity derivatives, fixed income, fixed income derivatives, fx derivatives etc.

It will be important to bring to your kind attention that through the above experience, we have developed experienced man power, across exchange operations from trading, clearing, settlement, risk management, surveillance, technology, investor education, grievance rederessal etc., and thus the said experience may be leveraged to build robust and liquid platform for Natural Gas in India and bring appropriate leadership strength for setting up and running of the proposed Gas Exchange.

Therefore, it is suggested that appointment of CEO of the Exchange be decided by the Nomination and Remuneration Committee and the Board of the Exchange and name of the selected candidate be submitted to PNGRB for ratification. The same process may be allowed

to be followed for 2nd term of the candidate. If the NRC and Board decide to go beyond 2 terms, then public selection process may be required to be followed.

8. Regulation 30 (Statutory Committees): NSE seeks a flexibility from the Board in formation of the committees for the following reasons:
 - Market feedback across the value chain is essential for building the market in the initial period. Market development and penetration should be the primary focus with adequate compliance norms.
 - Committees related to market surveillance, Advisory and oversight should be mandated while the rest can be optional in nature for the first 3-year period.
9. Regulation 34 – Risk Management by Gas Exchange. It is proposed that PNGRB should specify basic risk management framework which Gas Exchanges / Clearing Corporations must adhere to. Gas Exchanges / Clearing Corporations will be given an option to impose additional requirements if they so choose. But minimum requirements as prescribed by PNGRB have to be followed. This will ensure that market development happens in an orderly manner and there is no race to the bottom in the crucial area of risk management.
10. Regulation 35(2)-lays down the mechanism for meeting the obligations of the defaulter trading member. In our understanding, express powers need to be bestowed with the gas exchanges to take over assets of the defaulter trading member deposited with the exchange. Under the stock exchange mechanism once a member is declared a defaulter, the assets of such a member are vested with the defaulter committee of the exchange, which then distributes the assets in line with bye laws of the exchange. Power in terms of initiating actions (legal actions) against the defaulter trading member, if deemed necessary, may also be considered for the purpose of these Regulations.
11. Regulation 42.(3)a. lays down the contribution to be made to the SGF - Under stock exchange and clearing corporation mechanism contributions to SGF are also made by clearing members, the same may be considered in these Regulations as well.
12. Regulation 58 provides for Transaction Reporting-Under the PMLA the gas exchange would also be considered as reporting entity and hence these Regulations may include obligation on the part of the gas exchange to monitor and report transaction as provided under the PMLA Act and Rules including KYC related aspects. It may also be considered to include provision regarding reporting of transaction done by overseas trading members, if applicable.
13. Regulation 60 provides for laying down of Insider Trading policy- however it needs to be clarified whether the provisions of the SEBI Insider trading regulation would be applicable for the purpose of these regulations, if so, reference may be made here.