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A monthly round-up of financial RegTech news

Vinyamak

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Reserve Bank of India (RBI) releases directions on The Electronic Trading Platforms 2018

The RBI issued final guidelines to the entities operating electronic trading platforms (ETPs). As per the norms issued by the central bank, ETPs constitute any electronic system, other than a recognised stock exchange, on which transactions will be carried out for eligible instruments. The final direction was published on 5 October 18 based on the public consultation feedback on the draft ETP direction released almost a year back.

Trading on electronic platforms is being encouraged across the world as it enhances pricing transparency, processing efficiency and risk control. It also enables better market surveillance and, therefore, discourages market abuse and unfair trading practices.

Summary of the directions

General guidelines:

1. Prior authorisation from the RBI is mandatory for any entity to operate an ETP under these directions.
2. For already existing or operating ETPs, applications for authorisation have to be made within a period of six months from the date of issue of these directions. Until this authorisation is granted or rejected by the RBI, an existing ETP operator may carry on with its operations.
3. Only transactions in instruments approved by the RBI shall be hosted by the authorised ETPs.

Exception:

An exception to these directions would be in cases where ETPs are operated by banks for their customers (who are acting as users) on a bilateral basis. This exception would only be applicable when the ETPs do not extend direct or indirect access to market makers in any markets for eligible instruments (including purposes such as foreign exchange transactions, authorised dealers).

Eligibility criteria for authorisation of ETPs

General criteria

- Country of of incorporation of the entity should be India.
- Exisiting entitites, if not incorporated in India, should conform to the requirements of incorporation in India within one year from the date of issue of authorisation by the RBI.
- Shareholding by non-residents shall conform to all applicable laws and regulations, including the Foreign Exchange Management Act, 1999.
- Entities shall have experience of at least three years in operating trading infrastructure in financial markets.
- These criteria will not apply to ETPs operated by Scheduled Commercial Banks.

Financial criteria

- The entity shall have a minimum net worth of 5 crore INR and shall continue to maintain it.
- Exisiting entities operating with a lower net worth shall achieve the minimum requirement within a year from the issue of authorisation from the RBI.
- Banks seeking authorisation to operate an ETP shall keep aside a minimum capital of 5 crore INR for this purpose.

Technological criteria

- Entities shall have the capability to disseminate trade information on a real-time basis or near real-time basis.
- The entity shall obtain and maintain robust technology infrastructure with a high degree of reliability, availability, scalability and security in respect of its systems, data and network.

Title and commencement of the directions

- The directions will be called Electronic Trading Platforms (Reserve Bank) Directions, 2018.
- They will be issued to the entities operating ETPs to transact trade in eligible instruments.
- They shall come into force with effect from 5 October 2018.

Grant of authorisation to operate ETP and cancellation

1. Entities may submit the application form for 'Authorisation to operate an Electronic Trading Platform' on satisfying the eligibility criteria prescribed under these directions.
2. If any clarification or information is required by the RBI, it may call for the same from the applicant and the applicant shall furnish such additional information.

Operating framework

Access and participation

- Objective, fair and transparent membership criteria
- Due diligence at the time of on-boarding
- Member identification using Legal Entity Identifier (LEI) and/or Permanent Account Number (PAN)
- Easy availability of pre-trade, post-trade and such other information in a fair and non-discriminatory basis
- Members should have easy access to documents pertaining to rules and regulations regarding on-boarding, suspension and cessation of membership, roles and responsibilities of members and operator, liability framework for ETP and users in case of breach of rules and regulations, restrictions or other requirements

Risk management

- Implementation of a risk management framework covering all aspects of operations ensuring that risks associated with its operations are identified and managed prudently
- **Trade integrity**:

  a. Ensure access control for its members, prevent unauthorised access to the platform
  b. Segregate the ETP from other financial services to prevent unfair access to the ETP
  c. Ensure all trades on the system are dealt with in a fair, non-discretionary and orderly manner
  d. Prevent transactions that are not in compliance with the conditions of authorisation or with the prevailing legal or regulatory requirements

- **Algorithmic systems**:

  a. Put in place a framework for testing and on-boarding of algorithmic trading systems
  b. Ensure such facilities are offered in a transparent, non-discriminatory manner
  c. Ensure systems and controls are adequate for monitoring risks

- **Control:**

  Ensure appropriate controls are in place to reduce erroneous transactions such as off-market quotes or trades, fat finger errors, unintended or uncontrolled trading activity by members

- **Handling exigencies**:

  To deal with exigencies like suspension/cessation of trading or cancellation of orders/trades, malfunctions in its systems or erroneous use by members, or any other unforeseen situation, an ETP operator shall put in place rules and regulations in a transparent manner

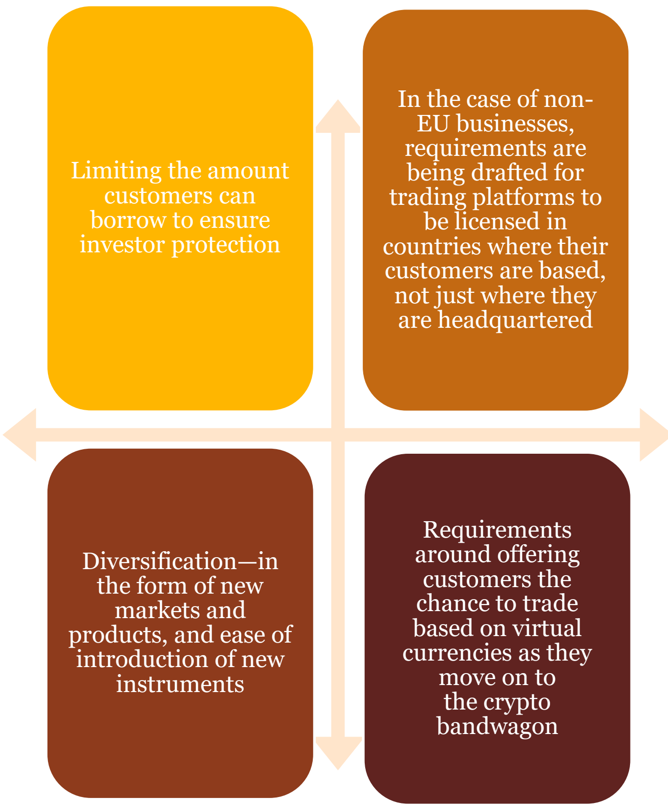
- **Dispute resolution**:

  Arrangement to address any dispute that may arise or is likely to arise between its members

Conclusion

While the RBI directive lists down essential criteria for bringing about key governance and controls into the system, a comparison with the regulations put forth by the European Securities and Markets Authority

(ESMA) shows some key aspects that the RBI can further consider:



With ETPs being encouraged across the world with a focus on enhancing pricing transparency, processing efficiency and risk control, the directives issued by the RBI should incorporate the above in due course, as collectively, they will be a key determinant in bringing about better market surveillance and in discouraging market abuse and unfair trading practices.

The complete discussion paper on the Electronic Trading Platforms (Reserve Bank) Directions, 2018, can be accessed here.

Regulatory news

Master Direction - Fit and Proper Criteria for Sponsors - Asset Reconstruction Companies (Reserve Bank) Directions, 2018

The RBI, through its official notification on 25 October 2018, has issued the directions on Fit and Proper Criteria for sponsors of registered Asset Reconstruction Companies (ARCs).

The notification details the following aspects of eligibility:

1. Determinants of fit and proper status of sponsors of ARCs
2. Information to be furnished by the sponsors along with relevant supporting documents
3. Continuous monitoring arrangements for due diligence in case of existing sponsors
4. Compliance with prior approval requirement

The official notification can be accessed here.

Basic Cyber Security Framework for Primary (Urban) Cooperative Banks (UCBs)

The RBI has released indicative guidelines on the basic cyber security framework to be implemented by all UCBs, given the importance of enhanced security from cyberthreats by improving the current defences in addressing cyber risks.

The framework discusses the following key points:

1. Need for a board approved cyber security policy
2. Cyber security policy to be distinct from information technology (IT)/information security (IS) policy
3. IT architecture/framework to be security compliant
4. Cyber crisis management plan

5. Organisational arrangements
6. Cyber security awareness
7. Ensuring protection of customer information
8. Supervisory reporting framework

The official notification can be accessed here.

Prepaid Payment Instruments (PPIs) – Guidelines for Interoperability

The RBI, through its official notification on 16 October 2018, released the operational guidelines and requirements on interoperability of PPIs, viz. mobile wallets, etc., through:

1. Card networks
2. Unified Payments Interface (UPI) platform

The notification highlights the common requirements in addition to separate requirements for UPI and card networks.

The complete notification can be accessed here.

RBI releases discussion paper on 'Voluntary Retention Route' (VRR) for investment by Foreign Portfolio Investors (FPIs)

The RBI has released a discussion paper on 'Voluntary Retention Route' (VRR) for investment by FPIs to receive comments from market participants.

The RBI, following discussions with the Government of India (GOI) and Securities and Exchange Board of India (SEBI), proposed to introduce VRR to enable FPIs to invest in debt markets in India.

The investments through this route would be free of the macro-prudential and other regulatory prescriptions applicable to FPI investments in debt markets, provided FPIs voluntarily commit to retain a required minimum percentage of their investments in India for a period of their choice.

The entire discussion paper can be accessed here.

On the importance of independent regulatory institutions – the case of the central bank

Dr. Viral V Acharya, Deputy Governor of the RBI, delivered a speech highlighting the importance of independent regulatory institutions as the A. D. Shroff Memorial Lecture.

The speech highlighted the independence of the central bank on the following points:

1. Government and the central bank – a tale of two horizons
2. Undermining the independence of the central bank
3. 'Kiss of death' – incurring the wrath of markets
4. Progressive evolution in restoring the independence of the RBI
5. Ongoing challenges in maintaining the independence of the RBI

The complete speech can be accessed here.

Preventive vigilance – the key tool for good governance at public sector institutions – Urjit R. Patel

In the RBI bulletin dated 11 October 2018, the RBI Governor discussed the conceptual framework that helps in understanding the various aspects of vigilance.

He also highlighted how preventive vigilance is crucial in government or public sector institutions and can act as a tool of good governance while punitive vigilance seeks to deter the occurrence of a lapse.

The governor further discussed the vigilance function and several measures at the RBI, concluding that simplifying rules and procedures and leveraging technology can strengthen the preventive vigilance framework, thereby ensuring compliance.

Details can be accessed here.

Other regulatory news

Participation of Eligible Foreign Entities (EFEs) in the commodity derivatives market

SEBI has issued guidelines for allowing foreign participants to hedge their commodity exposure in the light of feedback received from the market participants against the consultation paper dated 18 May 2018.

As per the guidelines, foreign entities having actual exposure to Indian commodity markets are allowed to participate in the commodity derivative segment of recognised stock exchanges for hedging their exposure. Such foreign entities shall be known as EFEs.

Details of the regulatory framework for participation by EFEs can be viewed here.

Advisory in respect of foreign trading portals

On 30 October 2018, SEBI issued an advisory against firms which are using online web portals to trade in a variety of financial products, including various types of derivatives traded on overseas platforms/exchanges.

SEBI further stated that such firms are not supervised by any regulatory body in India and that the inherent complexities of the products offered by such firms can result in losses to investors.

Investors are thus cautioned to avoid participating in such unregulated web portals/entities offering transactions in securities (including derivatives) which are executed or undertaken on the terminal of foreign exchanges/platforms.

The advisory can be viewed here.

Uniformity in the procedure for obtaining samples of goods at exchange accredited warehouses

SEBI has directed all exchanges and clearing corporations to follow the norms given below to bring uniformity in the procedures for obtaining samples for the purpose of assaying:

1. Ensure adequate samples of goods are collected/retained from the goods deposited
2. All the samples are sealed in the presence of the depositor or his authorised representative

The provisions of this circular shall come into effect from 16 October 2018.

The complete circular can be accessed here.

Global regulatory news

Prudential no longer deemed a non-bank systemically important financial institution (SIFI)

In a much-anticipated development, the Financial Stability Oversight Council announced on 17 October that it has voted unanimously to rescind the designation of Prudential Financial, Inc., as a SIFI, meaning that it is no longer subject to Federal Reserve supervision.

Of the four major non-bank firms originally tagged with the label by the Financial Stability Oversight Council (FSOC), Prudential was the last remaining non-bank with the SIFI designation. The council was established under Dodd-Frank and charged with broad authorities to identify and monitor excessive risks to the US financial system – but the law allows designated firms to have their status reviewed for de-designation.

'The Council's decision today follows extensive engagement with the company and a detailed analysis showing that there is not a significant risk that the company could pose a threat to financial stability,' said Treasury Secretary Steven Mnuchin, who chairs the FSOC, pursuant to Dodd-Frank.

Details can be accessed here.

SEC fines Citibank $38.7M for improper handling of American Depositary Receipts (ADRs)

Citibank paid a $38.7 million fine for improper handling of 'pre-released' ADRs, the Securities and Exchange Commission (SEC) announced this week.

ADRs are U.S. securities that represent shares of a foreign company. To be held in custody at a depositary bank, ADRs must have a certain number of foreign shares.

However, many banks engage in the practice of pre-releasing ADRs, which enables ADRs to be issued without the deposit of foreign shares as long as there is an agreement that the foreign shares correspond to the number of shares the ADR represents.

Details can be accessed here.

ESMA publishes data for Systematic Internaliser (SI) calculations for equity and equity-like instruments and bonds

ESMA has published the total number and total volume of trades executed in the EU over the period of April–September '18 for 17,999 equity and equity-like instruments and for 387,212 bonds. A market participant can now use this data to calculate if it is obligated to be an SI by comparing the trading it undertook in its own account compared to the total number and volume of trade in the EU.

For derivatives and other instruments, the announced date for data publication is 1 Feb 2019.

Details can be accessed here.

ESMA issues clarifications on clearing and trading obligations ahead of 21 Dec 2018 deadline

ESMA has issued a statement relating to the issues that certain financial and non-financial counterparties (NFC) which are above the clearing threshold will face on 21 Dec 2018 in starting a central counterparty clearing house (CCP) to clear their derivative contracts and trade them on trading venues.

ESMA expects that for the group entities that benefit from the derogation for intra-group transactions and NFCs that are not above the clearing threshold (as prescribed under the current EMIR legislation) in the interest rate derivative asset class, the competent authorities will generally apply their risk-based supervisory powers in their daily administration of applicable legislation in a proportionate manner.

Details can be accessed here.

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