

CIRCULAR

SEBI/HO/MRD/POD 3/P/CIR/2025/69

May 19, 2025

To

All Recognized Stock Exchanges

All Recognized Clearing Corporations

All Depositories

Sir/Madam,

Subject: Norms for Internal Audit Mechanism and composition of the Audit Committee of Market Infrastructure Institutions

1. Stock Exchanges, Clearing Corporations and Depositories (hereinafter referred as Market Infrastructure Institutions (MIIs)) are institutions that provide vital capital market infrastructure for trading; clearing & settlement; and holding, transfer & record keeping of securities. MIIs have a unique operating model in that they are empowered by law to regulate their members such as Trading Members, Clearing Members, Depository Participants, etc. The primary objective of an MII is to focus more towards serving as a crucial public utility infrastructure institution and a first line regulator for its constituents, while operating as efficient, innovative and competitive commercial entity.

A. Norms for the Internal Audit Mechanism at MIIs

2. It is essential that the MIIs shall operate in an efficient and transparent manner, be accountable for their actions, maintain highest standards of governance and risk management, etc. Internal audit helps to identify, assess, and mitigate risks that could

impact the MII's operations, efficiency, financial stability, etc. Internal audit also ensures that the MII's comply with relevant laws, regulations, circulars, guidelines, industry standards, etc.

3. MIIs being corporate entities governed by the provisions of Companies Act, 2013 are required to conduct Internal Audit. Further, in terms of 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), the governing boards of the MIIs are required to provide for three lines of defense of which the third line of defense comprises the Internal Audit Function.
4. In order to further strengthen the governance mechanism at MIIs, based on the feedback received from various stakeholders and recommendations of Secondary Market Advisory Committee of SEBI (SMAC), the following guidelines for the internal audit mechanism at MIIs have been prescribed:
 - 4.1. Every MII shall conduct internal audit of all functions and activities of the MII (i.e. functions and activities of Vertical 1 (Critical operations), Vertical 2 (Regulatory, compliance, risk management and investor grievances) and Vertical 3 (Other functions including business development)) at least once in a Financial Year.
 - 4.2. The internal auditor of the MII shall be an independent audit firm(s). The MIIs shall have a policy for appointment of internal auditors approved by the Audit Committee and governing board of the MII.
 - 4.3. Internal auditor of an MII shall report only to the Audit Committee of the MII.
 - 4.4. The scope of the internal auditor shall include all functions and activities of the MIIs (i.e. functions and activities of Vertical 1, Vertical 2 and Vertical 3) and shall be approved by the Audit Committee of the MII (including any other area as may be specified by the Audit Committee). Further, in order to standardize the terms of

reference of the internal auditor across similar MIIs, the MIIs may do so in consultation with the Industry Standards Forum of MIIs (ISF).

- 4.5. The observations of the internal auditor shall be sent to the respective Head of Departments (HoDs) for their comments in a time bound manner.
- 4.6. The internal auditor after incorporating comments of the HoDs shall share the final report with the Audit Committee in a time bound manner. Further, any initial observation(s) of the internal auditor, which have been dropped/closed subsequent to the clarifications/comments of HoDs, shall also be included in the Final Report, along with rationale/justifications for dropping such observation(s). Wherever required, the Audit Committee may seek views of other Statutory Committees of the MII on the observations of the internal auditor.
- 4.7. The various timelines for internal audit shall be prescribed by the Audit Committee of the MII.
- 4.8. The internal auditor of the MII shall appraise the Audit Committee, at least once in every six months within 60 days from the end of September and March, on critical issues concerning the MII, in the absence of the management.

B. Composition of the Audit Committee of the MII

5. The terms of reference of the Audit Committee (AC) amongst others involves approval of related party transactions, scrutiny of financial statements, evaluation of internal financial controls and risk management systems, etc. which requires objective evaluation of the functioning and decisions of the management.
6. In order to further strengthen the governance of the MII, based on the feedback received from various stakeholders and recommendations of the SMAC, the following have been decided:
 - 6.1. The Audit Committee of the MII shall not consist of any Executive Director (including the Managing Director) of the MII;

- 6.2. The auditors of the MII and the Key Management Personnel (KMPs) shall have a right to be heard in the meetings of the Audit Committee when it considers the auditor's report but shall not have the right to vote; and
- 6.3. Wherever required, the KMPs (including the MD) can be invited to attend the meeting of the Audit Committee with permission of the Chairman of the Committee but shall not have the right to vote.
7. **Applicability**: The provisions of the circular shall be applicable from the **90th day** of issuance of the circular.
8. All MIIs are advised to:
- i. Take necessary steps and put in place necessary systems for implementation of the above.
 - ii. Make necessary amendments to the relevant byelaws, rules and regulations, wherever required, for the implementation of the above; and
 - iii. Bring the provisions of this circular to the notice of the market participants (including investors) and disseminate the same on their website.
9. This circular is issued in exercise of the powers conferred under section 11(1) of the Securities and Exchange Board of India Act 1992 read with regulation 51 of the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018, section 26(3) of the Depositories Act, 1996 and regulation 97 of Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018 to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

10. This circular is available on SEBI website at www.sebi.gov.in at “Legal Framework - Circulars.”

Yours faithfully,

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