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# Sebi rejects MCX-SX application

Regulator says capital reduction doesn't comply with rules; exchange said to be planning appeal to SAT

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Mumbai: Capital market regulator Securities and Exchange Board of India (Sebi) on Thursday rejected the application of MCX Stock Exchange Ltd (MCX-SX) to run bourses trading various products, including stocks and equity derivatives, saying that it wasn't in "the interest of trade and public interest to allow the application".

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The exchange will appeal to the Securities Appellate Tribunal (SAT) against the decision, according to an exchange official familiar with developments.

MCX-SX is promoted by Multi-Commodity Exchange of India Ltd (MCX) and Financial Technologies India Ltd (FTIL), which hold 5% equity each and warrants amounting to economic interest of another 60%. The warrants are convertible into equity shares any time after the completion of six months from the date of allotment and are also freely transferable. But they do not carry voting rights. On conversion, they will become equity shares and rank on par with existing stock in all respects.

The application was rejected on the grounds that MCX-SX had violated Manner of Increasing and Maintaining Public Shareholding in Recognized Stock Exchanges (Mimps) rules, under which promoters are restricted to a 5% stake. The exchange will still be able to continue with currency trading activity.

"The concentration of economic interest in a recognized stock exchange in the hands of two promoters is not in the interest of a well-regulated securities market," K.M. Abraham, whole-time member of Sebi, said in a 68-page order. "The applicant is not fully compliant with Mimps regulations as substitution of shares by warrants is an attempt to work around the requirements of the regulation."

Sebi also found MCX-SX to be "dishonest in withholding material information on arrangements regarding the ownership of shares of its shareholders." It also held that the promoters "are persons acting in concert and can't hold more than 5% equity shares of a recognized stock exchange."

It also took serious exception to the buyback arrangements that MCX-SX had entered into with some shareholders.

MCX-SX was critical of the decision. "We are sad to see the continuation of the same bias and injustice as we have seen hitherto in the order passed by Sebi today. Despite the undertakings given to Sebi as per the order of Bombay high court, submitting legal opinions on the scheme of capital reduction and the submissions made in our reply to the notice of Sebi, it has still upheld the allegations mentioned in the notice," it said.

The exchange had found fault with the regulator in its response to a Sebi notice sent on 17 September, extracts of which were made available to *Mint*, saying the watchdog's

officials were associated too closely with the National Stock Exchange (NSE).

“When the above is seen in the backdrop of C.B. Bhave (the Sebi chairman) being former MD (managing director) and CEO (chief executive officer) of NSDL (National Securities Depository Ltd), a company promoted by NSE, it appears there is direct conflict of interest and the treatment given to MCX-SX qua NSE further prove the circumstances,” the response said.

MCX-SX said it was studying the order and will take appropriate measures in consultation with lawyers. “We have confidence and respect in the resilience of our judiciary and the appellate forums, and are sure that justice will be done to us in the near future. Until such time, we’d continue to work on our currency derivative segment.”

Lawyers said the order could have a significant impact on the exchange’s operations and reputation.

Siddharth Shah, partner at Nishith Desai Associates, a Mumbai-based law firm, said, “Unless it is appealed, the order would have significant impact on the existing operations (in the currency derivatives segment). Some of external investors would also be concerned. The observations made by Sebi in terms of honesty could be damaging, both from a business perspective and reputationally. It could also affect its chances with the Securities Appellate Tribunal.”

Shah said the exchange has the option to either take it up with SAT or go for a writ petition in the high court.

In September 2008, MCX-SX had been recognized as a stock exchange by Sebi with the condition that the promoters need to dilute their stake within a year’s time. When MCX-SX was formed, its promoters MCX and FTIL owned 51% and 49%, respectively, in it. Their stake came down to 37% and 33.9%, respectively, after the divestment of shares.

The firm got an extension of another year when the deadline for divestment lapsed last September. When Sebi renewed its recognition of MCX-SX as a stock exchange, it inserted a new condition that the bourse won’t be eligible to introduce any new class of contracts until shareholding norms are complied with.

This new condition, says the exchange, made it more difficult for it to find new investors, since such entities were willing to invest only after the bourse received approvals for operating in other segments. But Sebi would give approval for new segments only after the promoter stake was diluted. Given this challenge, the bourse had to resort to an unconventional method of capital restructuring, it said.

According to the capital restructuring exercise approved by the Bombay high court, the holdings of all shareholders came within permissible limits. However, the bourse issued 617.1 million warrants to MCX and 562.5 million warrants to FTIL. This arrangement allowed the promoters to gradually sell the warrants when the markets were conducive and valuations were agreeable. When the warrants are converted into equity shares by outside shareholders, the bourse’s equity base will expand and the promoters’ stake will fall below the 5% limit depending on the extent of conversion. The promoters can then convert warrants still in their possession into shares to keep their stake at 5%.

After getting court approval for this exercise, MCX-SX had written to Sebi on 7 April seeking to trade in new products. Sebi’s Thursday order disposed of this application.

Sebi pointed out that the exchange failed to comply with the shareholding norms satisfactorily, despite being given enough time for such compliance. It observed that the promoters delayed such divestment due to commercial considerations.

“What emerges from the submissions of the applicant is that the two promoters (holding

shares in excess of the prescribed limits) may not have been able to sell their shares at a price that was satisfactory to them. Sebi grants the recognition to a stock exchange. At what price a promoter or a shareholder wants to sell its shares in a stock exchange, needless to say, should not be the concern of Sebi," the order said.

"These are purely commercial considerations of the shareholders. However, I am of the considered view that Sebi's interpretation of 'full compliance' under Mimps regulations should not be tailored for meeting the business objectives of the promoters. It would patently be a failure on the part of Sebi as a regulator, were it to do so," it added.

In its representations to the regulator, counsel for MCX-SX suggested that Sebi should have been faster and asked for details even as the capital reduction scheme was being filed with the court.

Abraham dismissed this argument saying: "I would be loathe to think that the process of regulatory compliance of a stock exchange is a trivial game of getting the ball past the post first."

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