

Regulatory Hotline

January 12, 2016

SEBI NUDGES STOCK EXCHANGES FOR LISTING

- SEBI issues clarifications to facilitate Listing of Stock Exchanges in India.
- SEBI's Circular provides for modalities for monitoring shareholding limits and compliance with '*fit and proper*' criteria for all shareholders.
- Listed Stock Exchanges to ensure that 51% of its paid up equity shares are held by public at all times with the help of necessary systems put in place by the depositories.
- In relation to the fit and proper criteria, clear distinctions have been made between pre-listing and post-listing scenarios.
- Necessary mechanisms to be put in place by the Stock Exchanges and the depositories latest by March 31, 2016.

INTRODUCTION

Listing of Stock Exchanges¹ ("**Listing**") has garnered considerable media attention.² To assuage investors apprehensions on being able to exit their positions in Stock Exchanges and to enable listing of Stock Exchanges, Securities and Exchange Board of India ("**SEBI**") started the New Year with a bang and issued circular dated January 1, 2016 on procedure for ensuring compliances by Listed Stock Exchanges ("**2016 Circular**"). The 2016 Circular appears to be an effort to smoothen compliances with and to make the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 ("**SECC Regulations**") more robust. The 2016 Circular prescribes certain additional modalities to be fulfilled to ensure compliance with the provisions of SECC Regulations relating to public shareholding limits, fit and proper criteria for the shareholders and strict adherence to shareholding thresholds.

Issuance of the 2016 Circular is a welcome measure in ensuring transparency and accountability in ownership of Stock Exchanges and should help Stock Exchanges expedite the process for Listing. Listing of Stock Exchanges will help give fillip to the capital market. As per the reports, NSE and BSE have a market capitalization of INR 18,000 Crores (approximately)³ and INR 3,800 Crores (approximately)⁴ respectively, which is expected to increase manifolds upon listing.

BACKGROUND

As a result of the compulsory corporatisation and demutualisation ("**Demutualisation**") of Stock Exchanges mandated by SEBI in 2004⁵ under Section 4A of Securities Contract (Regulation) Act, 1956, Stock Exchanges converted themselves to a demutualised set up in India. Subsequently, in 2006, SEBI issued Securities Contracts (Regulation) (Manner of Increasing and Maintaining Public Shareholding in Recognised Stock Exchange) Regulations, 2006 ("**MIMPS Regulations**") which prescribed regulations pertaining to the manner of increasing and maintaining public shareholding with a minimum of 51% in Stock Exchanges. It further restricted any person from, directly or indirectly, acquiring or holding more than 5% in the paid-up equity capital of a Stock Exchange or from holding more than 1% of the paid up equity capital of a Stock Exchange without SEBI's approval, as a result of which the shareholding patterns of the Stock Exchanges had to be changed accordingly.

MIMPS Regulations enabled Stock Exchanges to raise their public holding either by fresh issue of equity shares to the public through issue of prospectus or through offer for sale or private placements of shares held by shareholders having trading rights. It also provided that where any fresh issue of equity shares or offer for sale to the public was made, an application for Listing thereof shall be made to the same or any other Stock Exchange as per the applicable regulations in compliance with such conditions as may be specified by SEBI.⁶

Subsequently, in 2012, SEBI issued the SECC Regulations which repealed⁷ the MIMPS Regulations and put a restriction on the self-listing regime by allowing Stock Exchanges to list only on exchanges other than itself and its associated Stock Exchange subject to prescribed conditions.⁸ SECC Regulations further allows SEBI to specify such conditions as it may deem fit in the interest of the securities market including those in relation to the transfer of shares held by any person⁹ and it is in exercise of these powers and to achieve these objectives that 2016 Circular has been issued.

KEY POINTS OF THE 2016 CIRCULAR

a) Public shareholding of 51 % at all times by the Listed Stock Exchange

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As per Regulation 17 of SECC Regulations, Stock Exchanges are required to maintain a public shareholding of at least 51% of its paid up equity share capital with individual limit being 5%. Domestic Stock Exchanges, Depositories, Banking Companies, Insurance Companies and Public Financial Institutions are excluded and can hold up to 15% of the paid up equity share capital. SEBI in an earlier circular on Procedural norms on Recognitions, Ownership and Governance for Stock Exchanges and Clearing Corporation dated December 13, 2012, ("**2012 Circular**") had prescribed certain guidelines with respect to monitoring of such shareholding limits. It required the Stock Exchanges to put in place a monitoring mechanism to ensure compliance with the shareholding restrictions and instructed them or the Stock Exchange on which the shares may be listed, to disseminate on its website, the shareholdings of shareholders belonging to non-public, Foreign Institutional Investor and Foreign Direct Investor category. Upon breach of shareholding limits, they were to intimate the same to SEBI within 7 days.

In light of recent discussions in press surrounding the difficulties that may arise in monitoring the shareholding limits upon the Stock Exchanges getting listed¹⁰, SEBI has instructed the depositories to put in place a necessary system to ensure that the shareholding of trading members or their associates and agents ("**Non-Public**") do not exceed 49%.

Non-Public shareholders shall obtain prior approval of the listed Stock Exchange for further acquisition of shares, once the aggregate shareholding of such shareholders exceed the limit of 45%. In the event of Non-Public shareholders making purchases without the requisite approval, depositories shall have the power to freeze their voting rights and all corporate benefits in respect of such shareholding till the time the same is divested.

b) All shareholders to be 'fit and proper'

Regulation 19 of SECC Regulations states that no person shall '*directly or indirectly, acquire or hold equity shares of a recognised Stock Exchange unless he is a fit and proper person*'. In the 2012 Circular SEBI had prescribed that the Stock Exchanges may also lay down any fit and proper criteria without diluting and limiting the principles and criteria laid down in Regulation 20¹¹ of SECC Regulations to ensure that all their shareholders are fit and proper. The 2016 Circular, in an attempt to put an end to the concerns surrounding fit and proper criteria post-listing of Stock Exchanges, has prescribed distinct provisions for pre-listing and post-listing scenario. It states that that Stock Exchanges making public offering before Listing shall include a declaration in the application form for allocation of shares stating that the applicant is fit and proper in terms of Regulation 19 and 20 of SECC Regulations. In the post-listing scenario, the text of the applicable regulation with regard to fit and proper shall be made part of the contract note.

SEBI has also instructed the concerned Stock Exchange and the Stock Exchange where its shares are listed, to undertake all measure to make its investors aware of the requirement of fit and proper criteria and shall notify on their websites that shares of the listed Stock Exchange shall only be dealt by fit and proper persons.

In the event acquisition of share by a person who is found to be not fit and proper, the depositories shall have the power to freeze their voting rights and all corporate benefits in respect of such shareholding till the time the same is divested through a special window.

c) Fit and proper criteria for shareholders holding shares above 2%

Shareholder acquiring paid up equity shares in a Stock Exchange above the limit of 2% or 5% (subject to their eligibility) will have to comply with the aforementioned conditions in addition to the substantive standards set out in Regulation 19(2) and 19(3) of SECC Regulations that provides for SEBI's approval within 15 days of the acquisition above 2% and prior approval of SEBI for acquiring more than 5% of the paid up equity shares. Regulation 19(6) of SECC Regulations requires the shareholders holding more than 2% of shares in a Stock Exchange to file a declaration to the Stock Exchange within 15 days from the end of every financial year that they comply with the fit and proper criteria requirements provided in these regulations.

d) Monitoring of shareholding threshold of 5% or 15% in terms of SECC Regulations

The 2016 Circular provides that depositories shall put in place a mechanism that would ensure that no shareholder of a listed Stock Exchange gets credit of shares beyond 5% or 15%, as applicable. The depositories shall generate an alert when such holdings exceed 2% and monitor the same under intimation to SEBI. Depositories are obligated to inform the Listed Stock Exchange as and when the threshold limits are breached and take consequential action of freezing the voting rights and all corporate benefits in respect of such shareholding till the time the same is divested through a special window.

SEBI, encouraging Stock Exchanges for Listing, has directed that Stock Exchanges submitting an application to SEBI for Listing shall ensure strict compliance with Chapter VII (i.e. Listing of Securities) of SECC Regulations and 2016 Circular. Listed Stock Exchanges, the Stock Exchange where such Stock Exchange is listed and depositories are to ensure that the requirements of 2016 Circular and SECC Regulations are in place by March 31, 2016. Lastly, it has advised Stock Exchanges to make necessary amendments to its bye-laws, rules or regulations, for immediate incorporation of the above compliance mechanism and communicate to SEBI the status of implementation of the 2016 Circular in the Monthly Development Reports to SEBI.

CONCLUSION

Kania Committee suggested Listing as the next big step after demutualisation and this was reflected in the MIMPS Regulations. However, due to lack of clarity in the regulations and certain concerns raised by the Jalan Committee Listing has not seen light of the day.

SECC Regulations issued by SEBI subsequent to Jalan Committee Report brought out certain key modifications to the regulatory regime. The 2016 Circular has gone further to make the Regulations more comprehensive with substantive and procedural compliances. The 2016 Circular is a clear indication that Stock Exchanges may take advantage of Listing and that SEBI has reiterated its acknowledgement of the benefits of Listing.

The 2016 Circular is also an attempt to strike a balance between operational convenience and compliance with the law in spirit. The modalities provided in the 2016 Circular should go a long way in securing compliance and should also dispel any concerns about how the Regulations will be enforced and pave way for BSE and NSE to apply for Listing.

¹ Regulation 2(j) of Securities Contracts (Regulation) Act, 1956

"stock exchange" means—

- a) any body of individuals, whether incorporated or not, constituted before corporatisation and demutualisation under sections 4A and 4B, or
- b) a body corporate incorporated under the Companies Act, 1956 whether under a scheme of corporatisation and demutualisation or otherwise,
- for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

² <http://www.thehindubusinessline.com/portfolio/macro-view/the-exchangelisting-impasse/article7983496.ece>; see also http://www.business-standard.com/article/markets/sebi-brings-in-caveat-on-stock-exchange-listing-115122200788_1.html; see also <http://www.livemint.com/Home-Page/Z1ppPjdaIX1KM6fA825IP/Sebi-spells-out-compliance-norms-for-investors-of-listed-exc.html>

³ <http://www.dealstreetasia.com/stories/india-nse-tells-shareholders-it-has-submitted-restructuring-proposal-to-sebi-12915/>

⁴ http://thefirm.moneycontrol.com/story_page.php?autono=4267601

⁵ based on the recommendations of a committee headed by Justice M.H. Kania ("**Kania Committee**")

⁶ Regulation 5 of MIMPS Regulations.

⁷ Regulation 52 of SECC Regulations.

⁸ Regulation 45 of SECC Regulations.

⁹ Regulation 45(2) of SECC Regulations.

¹⁰ *Supra* 2

¹¹ Regulation 20 of SECC Regulations: Fit and proper criteria.

"(1) For the purposes of these regulations, a person shall be deemed to be a fit and proper person if—

a) such person has a general reputation and record of fairness and integrity, including but not limited to—

- (i) financial integrity;
- (ii) good reputation and character; and
- (iii) honesty;

b) such person has not incurred any of the following disqualifications—

- (i) the person, or any of its whole time directors or managing partners, has been convicted by a court for any offence involving moral turpitude or any economic offence or any offence against the securities laws;
- (ii) an order for winding up has been passed against the person;
- (iii) the person, or any of its whole time directors or managing partners, has been declared insolvent and has not been discharged;
- (iv) an order, restraining, prohibiting or debarring the person, or any of its whole time directors or managing partners, from dealing in securities or from accessing the securities market, 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 in the order has not elapsed;
- (v) any other order against the person, or any of its whole time directors or managing partners, which has a bearing on the securities market, has been passed by the Board or any other regulatory authority, and a period of three years from the date of the order has not elapsed;
- (vi) the person has been found to be of unsound mind by a court of competent jurisdiction and the finding is in force; and
- (vii) the person is financially not sound.

(2) If any question arises as to whether a person is a fit and proper person, the Board's decision on such question shall be final."

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