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DEMUTUALIZATION OF INDIAN STOCK EXCHANGES & THE ROLE OF SEBI

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I. INDIAN STOCK EXCHANGES

There are 23 stock exchanges of which two — the National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE) — have a strong nationwide presence and modern, automated trading systems which have attracted all significant stock brokerage houses across the country.Five relatively large stock exchanges continue to log in volume trades even as the future looks uncertain. These are: Calcutta, Delhi, Ahmedabad, Chennai and Cochin. The next tier comprises tiny stock exchanges such as Ludhiana, Bhubaneshwar, Indore, Kanpur, Coimbatore, Pune, Gauhati, Magadh, Jaipur, OTCEI, Baroda and others which form India's 23 bourses. Finally, there is the Inter-Connected Stock Exchanges of India (ICSEI) — an experiment based on the premise that if other exchanges insisted on retaining their separate identity it opened up a business opportunity by linking them up.[1]

Barring the two national stock exchanges almost all the others face a sure death, but refuse to admit it. Instead, the reality of negligible trading volumes has forced them to seek messy linkages with the two national bourses, through separate subsidiaries.

II. DEMUTUALISATION OF STOCK EXCHANGES:

In recent years, the shift towards de-mutualization is getting the Indian stock exchanges ready for global integration. De-mutualization is globally seen as the first step towards forming strategic alliance with other international stock exchanges.[2] Most of the indian stock exchanges, for that matter world over, are non-profit and mutual or co-operative organisations. in simple terms, the brokers who trade on them collectively own and run them. since the objective of a stock exchange and those of the brokers trading on them are different, the vesting of ownership and managerial rights with the brokers can often lead to a conflict of interests. and in most cases, it is the interest of brokers that is preserved over the interest of wider investing public. in fact, in recent times a number of instances of this have been unearthed at the indian stock exchanges. demutualisation is

[1]Indian Regional Stock Exchanges, available at http://www.surfindia.com/finance/regional-stock-exchanges.html

[2] Recently, a number of stock exchanges have demutualised and become corporate entities. leading among these are the nasdaq, the australian stock exchange (asx), the hong kong stock exchange, the singapore stock exchange, the chicago mercantile exchange, and the new york mercantile exchange. Last year itself, the london stock exchange and tokyo stock exchange took on a corporate structure by demutualsing.

increasingly being suggested as a measure to check this as it leads to the separation of the ownership and trading rights of the brokers.[3]

Through demutualisation, a stock exchange becomes a corporate entity with its own objectives. moreover, it transforms from a non-profit organisation. it becomes a profit-making company like any other corporate entity. The most obvious benefit of demutualisation is that it leads to the separation of the ownership and control of stock exchanges from trading rights of its members, which eliminates the conflict of interest between exchange and broker members. this reduces the chances of brokers using stock exchanges for personal gains.[4]

For the stock exchanges, demutualisation means access to more resources, which has become very important of late given that they have to invest massively in technology to offer contemporary trading platforms. also, with globalisation the need for entering into a strategic alliance with other exchanges or acquiring other exchanges for growth or even survival has become important. a corporatised structure is best suited for this as it facilitates faster decision making and easy access to finance.

III. THE ROLE OF SEBI:

The Securities and Exchange Board of India too has played its role in encouraging this dangerous subsidiary route. In fact, it is actively helping stock exchanges to find means of survival by permitting them to become Depository Participants in order to generate additional revenue. The obvious question is — why can't Indian stock exchanges display the pragmatism of global bourses and find a way to either merge with the bigger exchanges or simply wind up. The answer lies in the regulations which govern listing of companies — these give office-bearers of the small stock exchanges a reason to keep them alive. If companies were not forced to list on regional stock exchanges, but could go directly to the two national stock exchanges, there would no longer be any reason for regional exchanges to exist. But this has been rendered almost impossible by the KR Chandratre Committee which was set up to examine delisting of securities in 1997.[5]

The committee, in the process of permitting de-listing of securities and protecting investors, had made it almost impossible for small exchanges to wind up. It lays down two conditions for voluntary de-listing of securities: first, assent of the holders of the securities which are proposed to be delisted; and second, acquisition of the securities of the dissenting security holders at a price to be determined in the prescribed manner. The first condition is not a problem, but the second makes no sense at all.The second condition aims to ensure that shareholders located near regional stock exchanges have an exit opportunity by forcing the company to buy out

[3]What Exactly is Demutualization, Economic Times, 21 January 2002, available at http://www1.economictimes.indiatimes.com/articleshowarchive.cms?msid=38775591

[4]Shamshad Akhtar, "Demutualization of Asian Stock Exchanges–Critical Issues and Challenges", available at http://www.adb.org/documents/books/demutualization_stock_exchanges/default.asp

[5]KR Chandrate Committee, "Constitution of Committee", available at www.sebi.gov.in/commreport/dlist1.html

their holdings. It also prescribes some rules for fixing the purchase price. This condition would have made sense when there were no national stock exchanges. Today, the NSE and BSE have terminals at all regional exchanges locations, and attract higher volumes than regional exchanges.

All that the Chandratre rules have done is to prevent delisting of shares and perpetuate the vested interest in bourses to remain in business. It may be argued that the subsidiary route is SEBI's way of finding a solution, particularly since the BSE and NSE seem to have eagerly embraced the proposal. This requires members of a regional stock exchange to come together as one entity under the subsidiary umbrella and operate as a single member of the NSE or the BSE. At present, Bangalore and the Inter-connected Stock Exchanges have begun operations in a small way at the NSE. The Madras and Baroda exchanges have applied to the BSE; Hyderabad, Ludhiana and Pune have applied to the NSE and the Ahmedabad Stock Exchange membership is caught up in structural issues. Ironically, the Inter-Connected Stock Exchange, which was to link the regional exchanges, has only added to the confusion by being the first to seek subsidiary membership on the NSE.[6]

IV. THE SUBSIDIARY ROUTE

Clearly, the subsidiary route raises a large number of questions about regulation, surveillance and discipline. The two big exchanges have found a simple way of dealing with these. They have merely decreed that each subsidiary will be treated as an individual member and it will be responsible for settling all regulatory and disciplinary issues and member disputes within itself. This is easier said than done. The BSE and the NSE are constantly in a struggle to discipline their members and to resolve inter-broker disputes. The NSE has a system whereby it attempts to resolve the problem by mediation. If that fails, it simply shuts down the brokers' trading terminals until they resolve the dispute. [7]

Frankly, it is impossible to visualise a large brokerage outfit (the subsidiary member) with 100 odd members, surviving for any length of time without serious disputes cropping up within its membership. The larger stock exchanges are perfectly aware that this could be a serious problem, but refuse to discuss it. After all, raising hypothetical issues at this stage will only antagonise the regulator and neither wants to do that. Instead the simpler alternative is to allow the subsidiaries to list and to begin trading. When the first unsolvable disputes crop up, they will simply be shut down. Interestingly enough, SEBI itself has prevented the subsidiary memberships turning into a major mess. The rules require SEBI to clear every member of the subsidiary separately and for various reasons this work has been progressing at a veritable snail's crawl.[8]

The lethargy of the regulator in pushing files has actually been a blessing in disguise. It would be even better if SEBI uses the opportunity caused by its delay to re-examine the Chandratre Committee's conditions and the feasibility of the subsidiary route and realises that closing down unviable bourses is better than keeping them on life-support systems.

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[6]Sucheta Dalal, "Global Mergers have No Lessons for Indian Stock Exchanges", available at www.suchetadalal.com/articles/display/80/1165.article

[7]Ibid.