Discussion paper on relaxation of shareholding restrictions in recognised stock exchanges

Background

1. At present, 18 recognised stock exchanges in India are corporatised and demutualised; i.e. they are companies limited by shares and at least 51 % of their equity share capital is held by public other than shareholders having trading rights therein.

2. Apart from NSE and OTCEI, which were already corporatised and demutualised, 16 more stock exchanges have completed their corporatisation and demutualisation process in the year 2007, in conformity with –

   - Securities Contracts (Regulation) (Manner of Increasing and Maintaining Public Shareholding in Recognised Stock Exchanges) Regulations, 2006 (MIMPS Regulations); and

   - Government of India policy regarding foreign investments in infrastructure companies in securities markets, viz. stock exchanges, depositories and clearing corporations, issued vide SEBI circular dated December 22, 2006.

3. As a part of the aforesaid corporatisation and demutualisation process, various investors like public sector banks, public sector insurance companies, PSUs, industrial development corporations, corporates and individuals have subscribed to the equity share capital of the stock exchanges. These investments are however subject to certain shareholding restrictions provided in the MIMPS Regulations and the foreign investment policy of the Government.

<u>Present Shareholding Restrictions</u>

4. Chapter III of the MIMPS Regulations provide for the following "Shareholding Restrictions" regarding the paid-up equity share capital of a recognised stock exchange -

   - **Regulation 8** - No person shall, directly or indirectly, acquire or hold more than **<u>five per cent</u>** in the paid up equity capital of a recognised stock exchange at any time after commencement of these regulations.

   - **Regulation 9** - No person shall, either individually or together with persons acting in concert with him, acquire and/or hold more than **<u>one per cent</u>** of the paid up equity capital of a recognised stock exchange after commencement of these regulations, unless he is a fit and proper person and has taken prior approval of the Board for doing so.

5. Further, the Government of India had specified the policy regarding foreign investments in infrastructure companies in the securities markets, namely stock exchanges, depositories and clearing corporations, which was communicated simultaneously by SEBI and RBI, vide respective circulars dated December 22, 2006. The said policy provides the following:

   - Foreign investment **<u>upto 49%</u>** will be allowed in these companies with a separate Foreign Direct Investment **<u>(FDI) cap of 26%</u>** and Foreign Institutional Investment **<u>(FII) cap of 23%</u>**;
   - FDI will be allowed with specific prior approval of FIPB;
   - FII will be allowed only through purchases in the secondary market;
   - FII shall not seek and will not get representation on the Board of Directors;
   - No foreign investor, including persons acting in concert, will hold **<u>more than 5%</u>** of the equity in these companies.

6. Thus, the current restrictions on shareholding in recognised stock exchanges may be summarized as under –

   - Restriction on any person from directly or indirectly acquiring or holding more than 5% in the paid up equity capital of a recognised stock exchange.

   - A person may acquire and / or hold, either individually or alongwith PACs, more than 1% in the paid up equity capital of a recognised stock exchange only with prior approval as “fit and proper person” from SEBI.

   - Restriction of maximum 49% foreign investment in stock exchanges, depositories and clearing corporations, with FDI limit capped at 26% and FII limit capped at 23%.

   - Restrictions on foreign investors, including PACs, from holding more than 5 % equity in stock exchanges, depositories and clearing corporations.

Issues under Consideration

7. The MIMPS Regulations have also been made applicable to NSE and OTCEI. In this regard, letters dated October 17, 2007 have been issued to NSE and OTCEI, thereby directing them to mutatis mutandis comply with the relevant provisions of the MIMPS Regulations. A time period of one year from the date of receipt of the above letter has been provided to them for ensuring compliance. In this regard, SEBI has received submissions from certain existing shareholders of NSE and OTCEI, whereby they have expressed various difficulties like possibility of not getting good price discovery, problems in fetching appropriate value of their investments, difficulty in getting eligible buyers, etc. in bringing down their present shareholding to the prescribed 5 % levels.

8. SEBI has also been receiving requests from certain quarters that the present limit of 5 % is acting as a deterrent for attracting long term anchor / strategic investors in stock exchanges. It is also indicated that due to the existing 5 % limit, the shareholding of any single investor / investor group is too small to encourage him / them to take sufficient interest in the growth of the exchange or to effectively drive the progress of the exchange as anchor investors.

9. The stock exchanges are public institutions and therefore as a matter of public policy, no individual investor should be allowed to hold a predominant position in them. At the same time, considering the market demands, it would be desirable to provide a high enough shareholding limit so as to encourage long term anchor / strategic investors who can contribute to the development of the stock exchanges. Such long term anchor / strategic investors need to be sufficiently motivated to take a keen interest in the functioning of the stock exchange and to contribute to its growth by providing the necessary value addition in terms of technology, market / product design, managerial inputs, etc. In view of the above, it would be desirable to explore a via media to enable a higher, but not too high a shareholding in stock exchanges by certain categories of investors in the financial market.

10. In this context, it is also seen that in the case of depositories, the sponsors are required to hold a much higher stake of minimum 51 % of any depository under the SEBI (Depositories and Participants) Regulations, 1996.

11. Considering the above, the aforesaid limit of 5 % is proposed to be revised upward to 15 % for certain category of investors, namely stock exchanges, depositories, clearing corporations, banks and insurance companies, while retaining the existing 5 % limit for the other investors. Accordingly, the following is being proposed –

- Any entity belonging to the following categories may be permitted to hold, directly or indirectly, a maximum of 15 % of the paid up equity share capital of the concerned stock exchange –

  - stock exchanges,
  - depositories,
  - clearing corporations,
  - banks, and
  - insurance companies

- Any shareholder, other than the aforesaid five categories of investors, may hold not more than 5 % of the paid up equity share capital of a recognised stock exchange, either directly or indirectly, as per the existing MIMPS Regulations.

- All other provisions of the MIMPS Regulations shall apply equally to the aforesaid five categories of investors as well.

Comments / suggestions are invited on the above and the same may be sent before September 19, 2008 to Mr. Deep Mani Shah, Assistant General Manager, Market Regulation Department, SEBI at the following address -

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The comments / suggestions may also be e-mailed to **deepmanis@sebi.gov.in**.

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