

THE SECURITIES AND EXCHANGE BOARD OF INDIA

EXIT ORDER IN RESPECT OF

VADODARA STOCK EXCHANGE LIMITED

1. Vadodara Stock Exchange Ltd. (hereinafter referred to as "VSEL") was incorporated on January 22, 1990 as a company limited by guarantee under the Companies Act, 1956. The Central Government had granted recognition to VSEL as a stock exchange under the provisions of section 4 of the Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as the 'SCRA') on January 05, 1990, which was subsequently renewed from time to time under rule 7 of the Securities Contracts (Regulation) Rules, 1957 (hereinafter referred to as the "SCRR").
2. The recognition of VSEL was last renewed by Securities and Exchange Board of India (hereinafter referred to as 'SEBI') for a period of one year commencing on January 04, 2014 and ending on January 03, 2015. The renewal was, however, subject to the condition that the Exchange could commence trading in securities only after complying with all the regulatory requirements imposed by the Securities and Exchange Board of India including full compliance with Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012.
3. SEBI, vide Circular No. MRD/DoP/SE/Cir-36/2008 dated December 29, 2008, issued Guidelines and laid down the framework for exit by stock exchanges whose recognition is withdrawn and/or renewal of recognition is refused by SEBI and who may want to surrender their recognition. The said Guidelines were reviewed and modified vide Circular No. CIR/MRD/DSA/14/2012 dated May 30, 2012 (hereinafter referred to as "Exit Circular"). In terms of clause 2.2 of the Exit Circular, a stock exchange where the annual trading turnover on its own platform is less than ₹1000 crore can apply to SEBI for voluntary surrender of recognition and exit, at any time before the expiry of two years from the date of issuance of the said Circular. In terms of clause 2.3 of the said Circular, if a stock exchange is not able to achieve the prescribed turnover of ₹1,000 crore on continuous basis or does not apply for voluntary surrender of recognition and exit before the expiry of two years from the date of the said Circular, SEBI shall proceed with compulsory de-recognition and exit of such stock exchanges, in terms of the conditions as may be specified by SEBI.
4. VSEL did not have any trading on its platform and it had not applied to SEBI for surrender of its

recognition and exit from the business of the Stock Exchange. In this regard, in line with the Exit Circular SEBI initiated compulsory exit of VSEL and the same was informed to VSEL vide SEBI letter dated December 04, 2014.

5. I note that as per the Exit Circular, *inter alia*, the following conditions are required to be complied with by the de-recognised/non-operational stock exchanges prior to exit:-
- (a). Distribution of its assets subject to certain conditions as laid down in the Exit Circular as well as the other guidelines that may be issued by SEBI, Governments or any other statutory body from time to time.
 - (b). For the purpose of valuation of the assets of the stock exchange, a valuation agency appointed by SEBI shall submit its report.
 - (c). The quantum of assets for distribution will be available after payment of the following by the stock exchange:-
 - (i) Statutory dues including Income Tax;
 - (ii) Transfer of Investor Protection Fund, Investor Services Fund, 1% security deposit available with the Exchange to SEBI Investor Protection and Education Fund (hereinafter referred to as the 'IPEF');
 - (iii) The exiting exchange shall pay the following dues to SEBI:-
 - Dues outstanding to SEBI including 10% of the listing fee and the annual regulatory fee;
 - The outstanding registration fees of brokers/trading members of such de-recognised stock exchanges as specified in the SEBI (Stock Brokers and Sub Brokers) Regulations, 1992, till the date of such de-recognition;
 - In case of any shortfall in collection of dues of the brokers to SEBI, the exiting Stock Exchange will make good the shortfall;
 - (iv) Refund of deposit (refundable) to the stock brokers including their initial contribution/deposit to Settlement Guarantee Fund/Trade Guarantee Fund (SGF/TGF).
 - (d). Contribution of up to 20% of its assets (after tax) towards IPEF taking into account, *inter alia*, the governance standards of the stock exchange and estimation of future liabilities.
 - (e). The companies exclusively listed on the stock exchange seeking exit shall list their securities on any other recognised stock exchange. If such exclusively listed companies fail to obtain listing on any other recognised stock exchange, they will cease to be listed companies and will be moved to the dissemination board by the exiting stock exchange. Such dissemination board would be provided by a Stock Exchange with nationwide trading terminals. The exiting stock exchange as well as exchange providing dissemination board will give wide publicity about the

dissemination board in one leading national daily and one local daily.

- (f). The exiting stock exchange shall set aside sufficient funds in order to provide for settlement of any claims, pertaining to pending arbitration cases, arbitration awards, not implemented, if any, liabilities/claims of contingent nature, if any, and unresolved investor complaints / grievances lying with it.
- (g). The exiting exchange may provide trading opportunity to their trading members to trade on stock exchanges having nationwide terminals through their subsidiary company, which will function as a normal broking entity.

6. I have considered all relevant documents available on record for the purpose of considering the case of exit of VSEL. With regard to the income tax obligation in respect of transfer of capital assets of a stock exchange, I note that section 47(xiii) of the Income Tax Act, 1961 provides as under:-

Section 47 (xiii):

Nothing in Section 45 applies to any transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, or any transfer of a capital asset to a company in the course of demutualisation or corporatisation of a recognised stock exchange in India as a result of which an association of persons or body of individuals is succeeded by such company:

Provided that –

(e) the demutualisation or corporatisation of a recognised stock exchange in India is carried out in accordance with a scheme for demutualisation or corporatisation which is approved by the Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992);]”

7. In respect of the tax treatment to a stock exchange post its corporatisation and demutualization, the following recommendation of the Justice Kania Committee which was the basis for the amendment in section 47(xiii) of the Income Tax Act, 1961 to provide tax benefit to the corporatised and demutualised stock exchanges is worth mentioning:

“as corporatisation and demutualisation of a stock exchange is essentially a conversion from a not-for profit entity to a for-profit company, and would result in a distribution of assets, the Income Tax Act should be amended if necessary, so that the past profits of an stock exchange which were not taxed when it had the character of a not for profit entity should not be taxed when its character changes. In other words, the accumulated reserves of the stock exchange as on the day of corporatisation should not be taxed. However, there would be no objection to taxation of these reserves, in the hands of the shareholders when these are distributed to shareholders as dividend at the net applicable tax rate; equally all future profits of the stock exchange after it becomes a for profit company may be taxed”.

8. The corporatisation and demutualisation scheme of VSEL was approved by SEBI vide notification F. No. SEBI/MRD/49397/ 2005 dated September 15, 2005 (hereinafter referred as "the scheme"). The scheme, *inter alia*, provided for the segregation of ownership and management from the trading rights of the members, restriction on voting rights of shareholders who are also trading members, composition of the Governing Board etc. in accordance with the provisions of section 4B(6) of the SCRA, utilization of assets and reserves and other matters required for the purpose of and in connection with the corporatisation and demutualisation of VSEL.
9. In terms of condition mentioned in para 5 (b) above, SEBI in consultation with VSEL appointed M/s Naresh and Co. on December 10, 2014 as Valuation Agency, for Verification and Valuation of Assets and Liabilities of VSEL. Vide its letter dated February 10, 2015, the Valuation Agency submitted its final report.
10. With respect to the compliance of conditions specified in the Exit Circular by VSEL and settlement of its liabilities observed by the Valuation Agency, it is important to note the following:-
- (a) In compliance of condition mentioned in para-5 (c) (ii) above, as advised by SEBI, VSEL has transferred the following to the SEBI Investor Protection and Education Fund (SEBI IPEF):
- (i) an amount of ₹2,33,00,301/- available in its 'Investor Protection Fund' vide transactions dated May 11, 2015, July 06, 2015, July 16, 2015 and August 13, 2015;
- (ii) an amount of ₹4,59,33,744/- available in its 'Investor Services Fund' vide Real Time Gross Settlement (RTGS) transaction dated April 09, 2015; and
- (iii) an amount of ₹36,64,440/- towards 1% security deposit vide transaction dated April 09, 2015 and April 22, 2015.
- (b) In compliance of condition mentioned in para-5 (c)(iii) above-
- (i) vide RTGS dated March 31, 2015, VSEL has transferred an amount of ₹21,074/- towards 10% of the listing fees received by the stock exchange;
- (ii) vide cheque no. "753704" dated March 31, 2015, VSEL has transferred the annual regulatory fee amounting to ₹1,00,000/-;
- (iii) vide RTGS transaction dated July 13, 2015 and July 15, 2015, VSEL has paid ₹55,63,983/- and ₹84000/- towards the outstanding registration fees of stock brokers and sub-brokers, respectively as specified in the Securities and Exchange Board of India (Stock Brokers and Sub Brokers) Regulations, 1992 till the date of such de-recognition.
- (c) In compliance of condition mentioned in para-5(d) above, VSEL has contributed an amount of ₹30,00,000/- vide RTGS dated August 14, 2015 towards SEBI IPEF.

(d) VSEL has submitted an undertaking dated August 06, 2015 (hereinafter referred to as “Undertaking”) *inter alia* undertaking and stating that:

- (i) in compliance of condition mentioned in para-5(c)(iv) above, VSEL will not distribute any assets before clearing the liabilities in that regard.
- (ii) in compliance of condition mentioned in para-5(e) above VSEL has taken necessary steps to refer the companies exclusively listed on its board to the Dissemination Board of BSE Ltd. and has undertaken to comply with SEBI circulars dated May 30, 2012, May 22, 2014 and April 17, 2015 and any other circular/directions that may be issued by it from time to time;
- (iii) in compliance of condition mentioned in para-5(f) above, VSEL has *inter alia* stated that:
 - there are no arbitration disputes/investor complaints pending;
 - no claims have been lodged against it;
 - it undertakes complete responsibility for the financial implication of any claims against it that may arise at any future date as an outcome of the resolution/settlement of the cases pending against VSEL.
- (iv) with regard to its other liabilities and contingent liabilities as pointed out by the Valuation Agency, VSEL has stated the extent of discharge of liabilities and has undertaken to clear the said liabilities before the distribution of its assets. It has also undertaken to clear any additional amount that may become liable to be paid on account of liabilities as stated in para 1 of the Undertaking.
- (v) in compliance of condition mentioned in para 5(g) above, VSEL has undertaken and declared that VSEL Stock Services Ltd., a functional subsidiary of VSEL, is a corporate member of National Stock Exchange of India Ltd., BSE Ltd. and Metropolitan Stock Exchange of India Ltd. and is providing trading facilities to all those trading members of VSEL who have opted for the same.
- (vi) the details of cases lodged against VSEL and as submitted by it to SEBI are the only cases pending before various legal fora and that it assumes complete responsibility for the financial implication of any claims against it that may arise at any future date as an outcome of the resolution/settlement of those cases.

11. SEBI had conducted inspection of VSEL in September, 2013 during which certain financial irregularities in the stock exchange and violation of/non-compliance with the SEBI guidelines were observed. In view of the same, VSEL has submitted an undertaking dated September 21, 2015 stating as under:

"VSEL shall keep its documents in proper form in all conditions except condition beyond control & condition

arising due to natural calamities and the same shall be made available to Securities & Exchange Board of India, Mumbai, for any future reference or regulatory proceedings, if any."

12. From the valuation report and the Undertaking of VSEL, it is observed that all the known liabilities have been brought out and that there is no future liability that is not known as on date. I note that VSEL has substantially complied with the conditions contained in the Exit Circular subject to its undertakings. I, therefore, am of the view that it is a fit case for compulsory exit to VSEL in terms of clause 8 of the Exit Circular.
13. I, therefore, in exercise of the powers conferred upon me by virtue of section 19 read with provisions of section 11(1), section 11(2) (j) of the Securities and Exchange Board of India Act, 1992 and sections 4, 5 and 12A of the Securities Contracts (Regulation) Act, 1956 direct the exit of Vadodara Stock Exchange Limited as a stock exchange and hereby also direct it to:-
- (a) comply with its tax obligations under the Income Tax Act, 1961;
 - (b) comply with the undertakings given by it to SEBI;
 - (c) comply with other consequential conditions of the Exit Circular;
 - (d) change its name and in case, after exit as a stock exchange, it continues as a corporate entity under the Companies Act, 2013, it shall not use the expression 'stock exchange' or any variant in its name or in the name of its subsidiary so as to avoid any representation of present or past affiliation with the stock exchange;
 - (e) provide required information to the Ministry of Corporate Affairs on identifying any vanishing company which was listed on Vadodara Stock Exchange Limited for inclusion in the list of vanishing companies maintained by the Ministry of Corporate Affairs.
14. This order shall come into force with immediate effect. A copy of this order shall also be forwarded to the Income Tax Authorities and the State Government of Gujarat and the Ministry of Corporate Affairs intimating the exit of Vadodara Stock Exchange Limited and for appropriate action at their end as per applicable laws.

Sd/-

DATE: NOVEMBER 9th, 2015

PLACE: MUMBAI

RAJEEV KUMAR AGARWAL

WHOLE TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA