

Drawing the line between profit and accountability

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A silver lining of the recent global financial crisis has been the subsequent introspection on market structures and institutions, and how their interplay could impact systemic stability.

In 2010, India's securities regulator, the Securities and Exchange Board of India (SEBI), received the report of the Bimal Jalan Committee (chaired by a former governor of the Reserve Bank of India), which reviewed ownership and governance of market infrastructure institutions such as stock exchanges and clearing corporations (MIs) in India.

More recently, pursuant to proceedings in the Supreme Court of India concerning the MCX Stock Exchange, SEBI notified the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012, on 20 June (SECC Regulations), to regulate the recognition, ownership and governance of stock exchanges and clearing corporations in India. The SECC Regulations replace the Securities Contracts (Regulation) (Manner of Increasing and Maintaining Public Shareholding in Recognized Stock Exchanges) Regulations, 2006 (MIMPS Regulations).

Mandatory recognition

While obtaining recognition from SEBI is a prerequisite to carrying on the activity of an exchange or clearing corporation in India, existing recognized exchanges will be deemed as recognized stock exchanges under the SECC Regulations. However, existing clearing corporations are required to apply for recognition within three months of the June notification.

MIs seeking recognition will be required to comply with the exhaustive criteria laid down by the SECC Regulations, including the requirement for bourses and clearing corporations to attain, within three years, a minimum

net worth of ₹1 billion (US\$18 million) and ₹3 billion (US\$54 million) respectively, which might lead to consolidation among existing players.

Stock exchanges are required to have a minimum public shareholding of 51% and a maximum shareholding of 5% per person (other than bodies such as banks which may hold up to 15%). Such a dispersed shareholding pattern with widespread public participation for stock exchanges is expected to act as a check against manipulation in favour of any interest group.

For clearing corporations, a minimum shareholding of 51% is to be held by one or more stock exchanges, subject to no exchange holding more than a 15% stake in more than one clearing corporation.

However, both existing stock exchanges and clearing corporations have a possible maximum of three years from the June notification to comply with the shareholding norms. This delayed timeline for compliance is expected to ease the dilution of promoter stakes.

The SECC Regulations emphasize divorcing the commercial and regulatory aspects of MIs. For instance, trading/clearing members are prohibited from being part of the governing board of the exchange or clearing corporation. While this move has been widely decried by brokers, who claim the right of representation at par with other stakeholders, given that the board is required to carry out regulatory oversight functions, such measures are justifiable to prevent conflicts of interest.

The SECC Regulations also require every clearing corporation to maintain a fund for guaranteeing the settlement of trades executed by it. Further, every recognized exchange is required to transfer a minimum of 25% of its annual profits to the clearing house

which clears or executes its trades.

While SEBI exercises overarching supervisory powers over the functioning of MIs, it has also mandated creation of various committees for internal management, with a view to fostering a culture of self-regulation. Emphasis has been placed on ensuring the independence of departments of an MI dealing with regulatory issues by the adoption of "Chinese walls" to segregate themselves from other departments, despite ongoing doubts about the efficacy of such structures.

Going public

In a major development, stock exchanges have been granted permission to seek listing after the completion of three years of continuous trading operations – a deviation from the recommendations of the Bimal Jalan Committee, which was not in favour of listing by MIs. The SECC Regulations do not yet contemplate the listing of clearing corporations.

The SECC Regulations convey mixed signals to MIs, with bourses being simultaneously told to list and yet transfer a substantial chunk of their profits. While modern market philosophy sees profit seeking by bourses as synonymous with efficiency and competition, conservative views echoed by the Bimal Jalan Committee advocate a limited commercial scope for MIs, given the sensitive nature of the information they are privy to.

Only time will tell whether the SECC Regulations can successfully amalgamate these seemingly irreconcilable viewpoints.

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