Stock exchanges – the more the merrier?

It is hard to argue against SEBI's intent to foster competition for stock exchanges and depositories. However, it is unclear if adding more stock exchanges will accomplish the desired outcome. While ownership regulations are being eased to lower entry barriers, SEBI needs to ensure this be done with stronger guardrails.

Source: morguefile.com

Competition is essential for continuous improvement to products and services, and to this extent, the intent of fostering greater competition for stock exchanges and depositories is in the right direction.

Increasing use of technology, breakdown of trading platforms, co-location issues, have all laced the 'equity' exchanges. Commodity exchanges too have seen their fair share of scams. While the regulator can provide an enabling environment, it cannot run the exchange. Therefore, the most enduring solution to customer delight is market-driven competition.

Will having more stock exchanges and depositories achieve that objective? SEBI, in its January 2021 discussion paper on "Review of Ownership and Governance norms for facilitating new entrants to set up Stock Exchange / Depository" believes it will[1].

SEBI has argued that newer technologies of block chain and distributed ledgers will bring an innovative element to trading and price discovery, and perhaps that will. If nothing else, it will increase the technology intensity of trading from its current levels.

Yet, India had over 20 stock exchanges in the past – most of them being local / territorial[2]. Although the Calcutta Stock Exchange continues (largely in name only), none of the other local / territorial exchanges survived against the size and liquidity of NSE and BSE (Exhibit 1). This is in line with global trends where multiple exchanges have converged into one dominant exchange. Other than USA, most of the other dominant equity markets – London, Tokyo, Singapore, Hong Kong all have a single stock exchange. And in USA too, these stock exchanges operate in niches (Exhibit 2).

This convergence to one exchange is testimony that liquidity begets liquidity. Adding more exchanges to the mix is unlikely to create competition – BSE has been trying to regain its lost market share on equity trades from NSE, but this has been a slow burn. Similarly, the Metropolitan Stock Exchange has not been able to make material inroads into equity trading. Force splitting liquidity across exchanges will be deleterious. While it will result in more arbitrage

[1] *The discussion paper relates to both Stock Exchanges and Depositories. Our commentary mainly relates to stock exchanges.*

[2] *The Hyderabad Securities and Enterprises Ltd (erstwhile Hyderabad Stock Exchange), Coimbatore Stock Exchange Ltd, Saurashtra Kutch Stock Exchange Ltd ,Mangalore Stock Exchange, Inter-Connected Stock Exchange of India Ltd, Cochin Stock Exchange Ltd, Bangalore Stock Exchange Ltd , Ludhiana Stock exchange Ltd, Gauhati Stock Exchange Ltd, Bhubaneswar Stock Exchange Ltd, Jaipur Stock Exchange Ltd, OTC Exchange of India , Pune Stock Exchange Ltd, Madras Stock Exchange Ltd, U.P.Stock Exchange Ltd, Madhya Pradesh Stock Exchange Ltd, Vadodara Stock Exchange Ltd, Delhi Stock Exchange Ltd and Ahmedabad Stock Exchange Ltd have been granted exit by SEBI vide orders dated January 25, 2013, April 3, 2013, April 5, 2013, March 3, 2014, December 08, 2014, December 23, 2014, December 26, 2014, December 30, 2014, January 27, 2015, February 09, 2015, March 23, 2015, March 31, 2015 ,April 13, 2015, May 14, 2015, June 09, 2015, November 09, 2015, January 23, 2017 and April 02, 2018 respectively.*

opportunities, it will also increase transaction costs, increase the bid-ask spread, and impact efficient price discovery.

Having decided to lower entry barriers, there are dangers to allowing 100% ownership of exchanges – even if it is for just the first ten years[3] (Exhibit 3).

Ab initio, SEBI will need to debate who will be given a license to start an exchange. The banking regulator has been reticent in allowing corporate houses to own banks. Dr. Raghuram Rajan, former Governor RBI, raised a prescient issue that some industrial houses constantly gain power, an issue that needs to be constantly examined. And so may be the case for allowing corporate houses to own stock exchanges. Therefore, simply asking promoters to have a minimum of five years' experience in either capital markets or the fintech industry is not sufficient. SEBI needs to articulate how it will address potential issues around conflict of interest for the owners of the new stock exchange.

SEBI's solution on strengthening the governance structure of the new stock exchanges and depositories by increasing the number of public interest directors on board committees is merely in form (Exhibit 4). If investors' outcry on the ineffectiveness of independent directors is anything to go by, this may equally become a check-box exercise.

SEBI must not allow disruption for disruption's sake. What SEBI needs are entrepreneurs with a purpose, which will involve an objective assessment of conflict of interest, as much as a subjective assessment of intent. But there is no clear path on how SEBI can assess intent.

Stock exchanges and depositories aid SEBI in its market surveillance, making them quasi-regulators and to that extent, public fiduciaries. This role was recognized by the Bimal Jalan Committee, which therefore mandated dispersed ownership of stock exchanges and depositories. If SEBI is to allow single ownership to an individual or an institution, it would be better placed in removing this regulatory function from stock exchanges and centralizing it

[3] *SEBI's discussion paper suggests that ownership levels be brought down to 51% or 26% after a 10-year period.*

under its own umbrella. In the past SEBI had proposed doing so through a Central Listing Authority[4], an idea that now needs to be resuscitated. This will allow SEBI to build capacity and strengthen its surveillance function. In doing so, however, stock exchanges will become purely commercial enterprises that provide a platform for trading. Commercial compulsions will drive better product design and service, but such compulsions could override the role of being a market fiduciary. To this extent, market participants will expect stronger oversight from the regulator.

SEBI is attempting to redefine the trading landscape with the innovation that newer technologies can bring. While the intent is forward-looking, it must bring in stronger guardrails to protect investors against a pure profit motivation. Otherwise, it must continue with the idea of maintaining dispersed ownership.

A modified / abridged version of this article was published on moneycontrol.com, which can be accessed here: https://bit.ly/2YUfQkD

[4] *Securities and Exchange Board of India (Central Listing Authority) Regulations, 2003. Published vide Notification Gazette of India, Extra, Part 2, Section 3(ii), No. 751, dated 21.8.2003. This notification was allowed to lapse, after the board and CEO was appointed and an office was taken on lease.*

Exhibit 1: List of stock exchanges on 17 January 2020

Sr. No.	Name of the Recognized Stock Exchange	Recognition Valid Upto	Segments Permitted
1	BSE Ltd.	PERMANENT	a. Equity b. Equity Derivatives c. Currency Derivatives (including Interest Rate Derivatives) d. Commodity Derivatives e. Debt
2	Calcutta Stock Exchange Ltd.	PERMANENT	
3	India International Exchange (India INX)	Dec 28, 2020	a. Equity Derivatives (Equity Index Derivatives & Single Stock Derivatives) b. Commodity Derivatives c. Currency Derivatives d. Debt
4	Indian Commodity Exchange Limited	PERMANENT	a. Commodity Derivatives
5	Metropolitan Stock Exchange of India Ltd.	Sep 15, 2021	a. Equity b. Equity Derivatives c. Currency Derivatives (including Interest Rate Futures) d. Debt
6	Multi Commodity Exchange of India Ltd.	PERMANENT	a. Commodity Derivatives
7	National Commodity & Derivatives Exchange Ltd.	PERMANENT	a. Commodity Derivatives
8	National Stock Exchange of India Ltd.	PERMANENT	a. Equity b. Equity Derivatives c. Currency Derivatives (including Interest Rate Derivatives) d. Commodity Derivatives e. Debt
9	NSE IFSC Ltd.	May 28, 2021	a. Equity Derivatives (Equity Index Derivatives & Single Stock Derivatives) b. Currency Derivatives c. Commodity Derivatives d. Debt Securities (Masala Bonds)

Note: India International Exchange Ltd and NSE IFSC Ltd have Single Segment across all asset/product classes.
Source: https://www.sebi.gov.in/stock-exchanges.html

Exhibit 2: Shareholders of stock exchanges in global markets

A. The New York Stock Exchange (NYSE)

The NYSE is owned by Intercontinental Exchange Inc, which, in turn, is held by institutions. The top three shareholders are the Vanguard Group Inc (7.8%), BlackRock Inc (7.1%) and T Rowe Price Associates Inc (5.1%).

B. NASDAQ

NASDAQ has dispersed shareholding with institutions owning a large share. Top shareholders include Borse Dubai Limited (18.1%); Investor AB (11.8%), Massachusetts Financial Services Company - 8.4% (Institution), and The Vanguard Group, Inc. (7.8%).

C. Tokyo Stock Exchange

Tokyo Stock Exchange is owned Japan Exchange Group, which in turn, has dispersed shareholding. Foreign corporations and others own 41.32%, Financial institutions own 28.53%, and securities companies and others own 23.61%.

D. London Stock Exchange

London Stock Exchange is owned London Stock Exchange Group Plc, which in turn has dispersed shareholding. London Stock Exchange Group Plc’s shareholder include Qatar Investment Authority (10.3%), Blackrock Inc (6.9%), The Capital Group Companies, Inc (6.8%), and Lindsell Train Limited (5.0%).

E. Singapore Stock Exchange

Singapore Stock Exchange ownership includes SEL Holdings PTE Ltd. (23.4%), Citibank Nominees Singapore PTE Ltd. (19.31%), DBS Nominees (Private) Ltd. (15.3%); DBSN Services PTE Ltd. (7.7%); and HSBC (Singapore) Nominees PTE Ltd. (6.6%)

Source: Individual stock exchanges’ annual reports

Exhibit 3: Extract of key changes related to ownership requirements suggested in SEBI’s discussion paper

Existing	Proposed
1. Individuals (Resident or Foreign) either directlyor indirectly, eitherindividually or together with persons acting inconcert, cannot hold more than 5% in a stockexchange or a depository. 2. Certain institutions (stock exchange,depository, bankingcompany, insurance company, both domestic and foreign, domestic public financial institution, foreign commodityderivatives exchange and a bilateral or multilateral financial institution approved by the central government)either directly orindirectly, either individually or together with persons acting inconcert, cannot hold more than 15% in a stock exchange or a depository. 3. Other entities(Domestic or Foreign) either directly or indirectly, eitherindividually or together with persons acting inconcert, cannot hold more than 5% in a stockexchange or a depository. 4. Combined holdings of all persons resident outside India cannot cross more than 49% ina stock exchange or a depository.	**A. In case of setting up a new Market Infrastructure Institution (MII):** **Resident Individuals / Domestic Institutions (resident Owned and Controlled)** 1. MII shall be a public limited company. 2. The promoter* setting up the MII may, directly or indirectly, either individually ortogether with persons acting in concert, holdup to 100% shareholding. 3. The shareholding of such promoter, directly or indirectly, individually or together with persons acting in concert, shall be brought down to not more than (either 51% or 26%) in 10 years from the date of commencementof business. **Foreign Individuals / Entities** 4. Foreign individuals / entities, who belong to /are regulated in FATF member jurisdictions respectively and are setting up the MII (as promoter), may directly or indirectly, either individually or together with persons acting in concert, hold up to 49% shareholding. 5. The shareholding of such foreign promoter, directly or indirectly, individually or together with persons acting in concert, shall be brought down to (either 26% or 15%) in 10 years from the date of commencement of business. 6. In the event of revocation / withdrawal of the membership of any jurisdiction from the FATF, individuals belonging to / entities regulated in such jurisdiction, shall berequired to bring down their shareholding in the MII to not more than 10% in five years from the date of such revocation / withdrawal. 7. Foreign individuals / entities other than thoseat Para A.4 above, may, directly or indirectly, individually or together with persons acting in concert, acquire or hold up to 10% in a MII. 8. Combined holdings of all persons resident outside India in a MII, shall not exceed, at any time, to 49% in terms of consolidated FDI Policy 2020.

Existing	Proposed
	Any person (domestic or foreign), other than the promoter and except those mentioned at Para A.6 and A.7 above, may directly or indirectly, either individually or together with persons acting in concert, acquire or hold less than 25% shareholding. **In addition to the above, the applicant / promoter (both domestic and foreign), shall comply with the following for setting up a MII;** 9. No conflict of interest 10. At least 50% of ownership of the proposed MII, shall be represented by Individuals / Entities having experience (5 years or more) in areas of capital markets or technology related to financial services. **B. In case of existing MIIs** **Individuals / Domestic Institutions (Resident Owned and Controlled)** 1. A person may, directly or indirectly, either individually or together with persons acting in concert, may acquire or hold up to 100% shareholding in a MII: Provided that any acquisition of 25% or more shall be subject to prior approval of SEBI and compliance with provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (in case of both, listed or unlisted MII). 2. In case of acquisition beyond 25%, the shareholding of such person (as referred at Para B.1 above), directly or indirectly, individually or together with persons acting in concert, shall be brought down to the level as applicable in case of setting up a new MII (i.e. either 51% or 26%) in 10 years from the date of closure of open offer. **Foreign Individuals / Entities** 3. Foreign individuals / entities, who belong to / are regulated in FATF member jurisdictions respectively may directly or indirectly, either individually or together with persons acting in

Existing	Proposed
	concert, acquire or hold up to 49% shareholding in a MII. Provided that any acquisition of 25% or more shall be subject to prior approval of SEBI and compliance with provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (in case of both listed or unlisted MII). 4. In case of acquisition beyond 25%, the shareholding of such person (as referred at Para B.3 above), directly or indirectly, individually or together with persons acting in concert, shall be brought down to the level as applicable in case of setting up a new MII (i.e. 26% or 15%) in 10 years from the date of closure of open offer. 5. In the event of revocation / withdrawal of membership of any jurisdiction from the FATF, individuals belonging to / entities regulated in such jurisdiction, shall be required to bring down their shareholding in the MII to not more than 10% in five years from the date of such revocation / withdrawal. 6. Foreign individuals / entities, other than those mentioned at Para B.3 above, may, directly or indirectly, individually or together with persons acting in concert, acquire or hold up to 10% in a MII. 7. Combined holdings of all persons resident outside India in a MII, shall not exceed, at any time, to 49% in terms of consolidated FDI Policy 2020.

Note: For the purpose of SEBI's discussion paper, MIIs referred to are stock exchanges and depositories.
Source: SEBI's discussion paper on "Review of Ownership and Governance norms for facilitating new entrants to set up Stock Exchange / Depository"

Exhibit 4: Extract of key changes related to governance requirements suggested in SEBI's discussion paper

4.2.1. The current and the proposed changes in the composition of the regulatory committees at MIIs are as under:

Name of the Committee	Current Composition	Proposed Composition	Rationale
Functional Committees			
Grievance Redressal Committee (GRC)	1. Only Independent External Persons (IEP). 2. One member for claims less thanRs. 25 lakh. 3. Three members (including onetechnical member) forclaims exceeding Rs.25 lakh.	1. One out of three members in the GRC should be PID in case of claims exceeding Rs.25 lakhs.	PID's inclusion inGRC would serveto boost investors' confidence in thegrievance redressal process. This will alsoboost the corporate governance practices whiledealing with aggrievedinvestors
Nomination and Remuneration Committee	1. Only PIDs 2. IEPs may be inducted in NRC only for recommending selection of MD & CEO.	1. Two PIDs and equivalent number of shareholder directors, if available. 2. IEPs may be inducted in NRC only for recommending selection of MD 3. MD & CEO shallbe permanentinvitee to the committee, except when his/ her appointment/ compensation/ performance appraisal is being considered	To facilitate wider stakeholder participation as currently onlyPIDs take criticaldecisions w.r.t.appointment at sensitive positions.
Oversight Committees			
Standing Committee on Technology	1. At least two IEPs proficient in tech	1. MD & CEO and Chief Technology Officer (CTO) to	The mandate ofthe committee is to monitor of systems along with

Name of the Committee	Current Composition	Proposed Composition	Rationale
	2. At least 50% PIDs	be permanent invitees 2. All other normsto be retained	other technology requirements andrequire proficientpeople. The proposed composition shall facilitate better decision making and risk management.
Regulatory Oversight Committee.	1. Only PIDs and IEPs 2. At least 50% PIDs 3. Shareholder Directors (SHDs) and KMPs may be invitees to the committee	1. May comprise of PID, SHDs (including MD & CEO) and IEP 2. KMPs may be invitees to committee 3. At least 50% PIDs	Mandated to oversee functioning of exchange and depositories, compliance with SEBI inspection report observations and implementation of SECC Regulations and SEBI(D&P) Regulations Participation from all categories to ensure compliance. Being an overseeing function, PIDs shall be in majority.
Risk Management Committee	1. PIDs & IEPs only 2. At least 50% PIDs	1. At least two PIDs along with IEPs, and a SHD (including MD & CEO) 2. At least 50% PIDs	Since the committee deals with formulation of risk management policy, it should have a balanced representation from all stakeholders.

Note: For the purpose of SEBI's discussion paper, MIIs referred to are stock exchanges and depositories.

Source: SEBI's discussion paper on "Review of Ownership and Governance norms for facilitating new entrants to set up Stock Exchange / Depository"

Disclaimer

This document has been prepared by Institutional Investor Advisory Services India Limited (IiAS). The information contained herein is solely from publicly available data, but we do not represent that it is accurate or complete and it should not be relied on as such. IiAS shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. This document is provided for assistance only and is not intended to be and must not be taken as the basis for any voting or investment decision and/or construed as legal opinion/advice. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigation as it deems necessary to arrive at an independent evaluation of the individual resolutions referred to in this document (including the merits and risks involved). The discussions or views expressed may not be suitable for all investors. The information given in this document is as of the date of this report and there can be no assurance that future results or events will be consistent with this information. This information is subject to change without any prior notice. IiAS reserves the right to make modifications and alterations to this statement as may be required from time to time. However, IiAS is under no obligation to update or keep the information current. Nevertheless, IiAS is committed to providing independent and transparent recommendation to its client and would be happy to provide any information in response to specific client queries. No copyright infringement is intended in the preparation of this document. Neither IiAS nor any of its affiliates, group companies, directors, employees, agents or representatives shall be liable for any damages whether direct, indirect, special or consequential including lost revenue or lost profits that may arise from or in connection with the use of the information. The disclosures of interest statements incorporated in this document are provided solely to enhance the transparency and should not be treated as endorsement of the views expressed in the report.

Confidentiality

This information is strictly confidential and is being furnished to you solely for your information. This information should not be reproduced or redistributed or passed on directly or indirectly in any form to any other person or published, copied, in whole or in part, for any purpose. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject IiAS to any registration or licensing requirements within such jurisdiction. The distribution of this document in certain jurisdictions may be restricted by law, and persons in whose possession this document comes, should inform themselves about and observe, any such restrictions. The information provided in these reports remains, unless otherwise stated, the copyright of IiAS. All layout, design, original artwork, concepts and other Intellectual Properties, remains the property and copyright of IiAS and may not be used in any form or for any purpose whatsoever by any party without the express written permission of the copyright holders.

Other Disclosures

IiAS is a SEBI registered research entity (proxy advisor registration number: INH000000024) dedicated to providing participants in the Indian market with independent opinions, research and data on corporate governance issues as well as voting recommendations on shareholder resolutions of about 800 listed Indian companies (https://www.iiasadvisory.com/iias-coverage-list). Our products and services include voting advisory reports, standardized services under the Indian Corporate Governance Scorecard, and databases (www.iiasadrian.com and www.iiascompayre.com). There are no significant or material orders passed against the company by any of the Regulators or Courts/Tribunals.

This article is a commentary on general trends and developments in the securities market.

About IiAS

Institutional Investor Advisory Services India Limited (IiAS) is an advisory firm, dedicated to providing participants in the Indian market with independent opinions, research and data on corporate governance issues as well as voting recommendations on shareholder resolutions for about 800 companies that account for over 95% of market capitalization.

IiAS provides bespoke research and assists institutions in their engagement with company managements and their boards. It runs cloud-based platforms, SMART to help investors with reporting on their stewardship activities and ADRIAN, a repository of resolutions and institutional voting patterns.

IiAS has equity participation by Aditya Birla Sunlife AMC Limited, Axis Bank Limited, Fitch Group Inc., HDFC Investments Limited, ICICI Prudential Life Insurance Company Limited, Kotak Mahindra Bank Limited, RBL Bank Limited, Tata Investment Corporation Limited, UTI Asset Management Company Limited and Yes Bank Limited.

IiAS is a SEBI registered research entity (proxy advisor registration number: INH000000024).