A Case for Central Listing Authority

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It is being argued in some circles that since the exchanges have failed to discharge responsibilities associated with listing of securities efficiently, a new mechanism in the form of a central listing authority (CLA) may be evolved. The question is if the CLA fails to discharge these responsibilities, should we evolve another mechanism? If we are in a vicious circle like this, it is better to improve the existing mechanism. But there are other weighty considerations behind the proposed CLA. These would be evident, if we look at the prevailing institutional arrangements and regulatory framework, and identify the difficulties/anomalies that we encounter today with it's working and can be addressed by the CLA.

Institutional Arrangement

The stock exchanges are the exclusive centres for trading of securities. We have today 24 exchanges (The Capital Stock Exchange, the latest in the list, is yet to commence trading) in the country recognised over a period of time to enable investors across the length and breadth of the country to access the market. The trading volumes on exchanges have been witnessing phenomenal growth for last few years. The growth of turnover has, however, not been uniform across exchanges. The increase in turnover took place mostly at big exchanges and it was partly at the cost of small exchanges that failed to keep pace with the changes. The business moved away from small exchanges to exchanges, which adopted technologically superior trading and settlement systems. The huge liquidity and order depth of big exchanges further sucked liquidity of other stock exchanges. As a result, about a dozen exchanges reported nil turnover during 2001-02, 15 small exchanges put together reported less than 0.01% of total turnover during 2001-02, and 21 exchanges together reported less than 4% of turnover, while 2 big exchanges accounted for over 96% of turnover (Table 1). For most of the exchanges, the *raison d'être* for their existence, i.e. turnover, has disappeared.

With fall in turnover, the financial health of many exchanges is deteriorating. While the income of the small exchanges is not increasing, they continue to incur increasing administrative and maintenance expenses and increased investment on setting up on-line trading and settlement systems. About a dozen exchanges suffered losses during 2000-01. The exchanges (except NSE and BSE) together incurred a total loss of about Rs. 17 crore while BSE and NSE earned handsome profits. The data for 2001-02, which was rather a difficult year when many exchanges witnessed negligible turnover, when available, would paint a further gloomy picture.

Such poor financial performance is despite the fact that the exchanges earn substantial amount of non-business income (income from listing, interest and rent). Listing contributes nearly Rs. 50 crore. This has become a perennial source of income for the exchanges and irrespective of the volume of business, it contributes almost the same amount year after year. The listing income accounted for as high as 84% of total income of Gauhati Exchange and 73% for MP Exchange (Table 1). Despite zero/negligible turnover, a few exchanges like Bhubaneshwar, Cochin, Gauhati, Madhya Pradesh, Madras, Mangalore, SKSE managed to earn a profit, albeit negligible, only because of their non-business income. If the exchanges were not having non-business income, only one exchange, i.e. NSE, would be earning profit during 2000-01 and the exchanges together would have posted a loss of Rs. 80 crore.

Table 1: Health of Stock Exchanges

Stock Exchanges	2001-02	2000-01		
	Distribution of Turnover (%)	Revenue Generation (%)		
		Listing	Interest & Rent	Business Income
Ahmedabad	0.76	51.16	34.11	14.74
Bangalore	0	27.46	26.81	45.73
Bhubaneshwar	0	20.29	71.33	8.39
Calcutta	1.39	14.01	23.89	62.11
Cochin	0	28.28	11.25	60.47
Coimbatore	0	9.11	76.75	14.14
Delhi	0.30	42.61	52.49	4.90
Gauhati	0	84.01	1.47	14.52
Hyderabad	0	55.42	18.21	26.37
ICSEIL	0	0.43	48.44	51.13
Jaipur	0	66.70	23.17	10.12
Ludhiana	0.04	31.70	34.86	33.44
Madhya Pradesh	0	72.62	10.57	16.81
Madras	0	58.83	23.01	18.16
Magadh	0	34.83	30.10	35.07
Mangalore	0	28.76	46.21	25.03
OCTEI	0	4.31	67.02	28.68
Pune	0.06	37.02	49.87	13.12
SKSE	0	22.27	59.32	18.41
Uttar Pradesh	1.30	19.4	39.15	41.46
Vadodara	0	29.69	50.09	20.22
Mumbai	15.89	8.64	35.02	56.34
NSE	80.25	0.84	16.28	82.88
Total (Except NSE & BSE)	**3.87**	**29.20**	**35.26**	**35.53**
Total	**100**	**8.70**	**25.19**	**66.11**

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This state of affairs will only worsen in the days to come. The financial health of the exchanges would look miserable for the year 2001-02 when a dozen exchanges have reported nil turnover. Another half a dozen would report nil turnover during 2002-03 as all deferral products have ceased to be available and exchanges have shifted to rolling (uniform) settlement cycles recently. Further, the business would keep on shifting from small exchanges to more sophisticated and big exchanges which provide quality processing of transactions. Small exchanges would become smaller and smaller and big would become bigger and bigger. These would reduce business income further for small exchanges. The listing income, which has been more in the nature of a fixed component, is only likely to decline in future once the process of de-listing of companies from these exchanges gains momentum. The process has already begun and a number of Indian blue chip companies have declared plans to delist their securities from small exchanges. According to an estimate (Prime Press Release dated February 18, 2002), 16 MNCs bought the entire equity of their Indian subsidiaries and delisted them from stock exchanges in 2001. And over 90 companies are in the pipeline. Besides, many issuers find it difficult to keep on paying listing fees and complying with listing requirements of a number of exchanges without any corresponding gains in terms of volume of transactions. The new issuers, who are also few, prefer exchanges with nationwide network. Interest income will also decline with decline in the interest rates in market. Besides as turnover decreases, the custodial deposits with exchanges also decline and hence interest earned on such deposits. While all the incomes (business, listing and interest) decline, expenditure would not decline proportionately.

This state of affairs has following implications:

(i) Given the speed of technological advances and trend in the market, extinction of a few stock exchanges is not a remote possibility. Quite a few exchanges will disappear sooner than later. There is nothing unusual in this. It is a normal market phenomenon that economic units come up and disappear due to market forces. But the exchange is just not an economic unit; it is also a SRO, a trustee for investors and a listing authority. If an exchange, where a security is listed, disappears, the listing authority as well as the trading platform for the security disappears. How can a regulatory entity disappear for commercial reasons? How can the trading platform for a listed security disappear? This reinforces the argument that securities should be listed, but not listed on/by a particular stock exchange, but by a third party which would not be extinct for commercial reasons and once listed, it should be available for trading on any exchange.

(ii) Listing signals that the issue has been properly supervised. The unwary investors take it as some kind of qualitative rating of the company, despite disclaimers to the contrary. Listing also casts onerous responsibilities on the exchange in the sense that it acts as a trustee for investors and ensures compliance of certain standards by a listed company. The issue is that are these exchanges, given their financial health and organizational structure, in a position to supervise such large number of listed companies (9644 companies listed on exchanges as at end of March 2002)? Given their dependence on listing income, can they discharge listing function efficiently? Can they easily deny a listing request? Can they suspend/delist a security without a second thought? Can they ruthlessly ensure compliance of obligations? No, as they can not easily offend a listed company in view of their interest. Take the recent case of declaration of interim dividend. When tax exemption on dividend was withdrawn, the companies tried to make pay out to investors in the form of interim dividend before the budget provisions were effected. This required relaxation of one of the terms of listing agreement. No exchange liked to refuse relaxation. They refused only at the behest of Government and SEBI. This therefore suggests the need for listing and supervision of a listed company through an independent authority who would not depend on listing income for survival.

(iii) Most of the exchanges are "Association of Persons" which was considered beneficial in terms tax benefits and matters of compliance. They are now having a re-look at the way they conduct business and are gearing up to demutualise themselves by converting themselves into a public limited companies. They will also be accessing securities market to finance their ever expanding trading network and would be interested to list their securities. This would create an anomalous situation where a stock exchange would admit its own securities for trading. A satisfactory solution would be to vest the listing powers with a body separate from the stock exchanges.

Regulatory Framework

Listing of securities on Indian stock exchanges is essentially governed by the provisions in the Companies Act, 1956, the Securities Contracts (Regulation) Act, 1956 (SC(R)A), the Securities Contracts (Regulation) Rules

(SC(R)R), 1957, rules, bye-laws and regulations of the concerned stock exchange, the listing agreement entered into by the issuer with the stock exchange and the circulars / guidelines issued by Central Government and SEBI.

The Companies Act, 1956 requires a company intending to issue securities to public to seek permission for dealing with its securities on one or more recognised stock exchanges. The prospectus should state the names of the stock exchanges where application for listing has been made and any allotment of securities shall be void if permission for listing is not granted by all the stock exchanges before expiry of 10 weeks from the closure of the issue. This means that every stock exchange, where an application has been made for listing, has a veto power and can prevent an issuer from making an issue.

Under the SC(R)A, the exchanges are empowered to make bye-laws which may provide for the listing of securities, and suspension or withdrawal of any such securities. The SC(R)R empowers the exchanges to grant listing, refuse listing, suspend or withdraw a security from listing either for a breach of or non-compliance with any of the conditions of listing or for any other reason. Each exchange exercises this power independent of any other exchange.

The listing agreement requires an issuer to agree that any of its securities listed on an exchange shall remain on the list entirely at the pleasure of the exchange which has right to suspend or remove from the list the said securities at any time and for any reason which the exchange considers proper in its absolute discretion. As a precondition for continuous listing, an issuer undertakes to forthwith comply with such future conditions as may be prescribed by the exchange.

A government circular requires that the companies wishing to list their securities must get listing on the regional (an exchange is considered regional for the state / Union Territory where it is located) stock exchange nearest to their registered office. If they so wish, they can seek listing on other exchanges also. Thus an issuer willy-nilly has to list its securities on a regional stock exchange.

A SEBI circular requires the basic norms for listing of securities on the stock exchanges to be uniform for all the exchanges who may prescribe additional norms over and above the minimum norms. These norms are part of the bye-laws of the stock exchanges. SEBI has been issuing guidelines / circulars prescribing certain additional norms to be included in the listing agreement and to be complied with by the companies. It advises the exchanges to amend/substitute a specified clause/ sub-clause of the listing agreement by the specified language. The exchanges in turn advise the companies that their listing agreement stands amended to that effect.

The SC(R)R, the bye-laws and the listing agreement prescribe a number of requirements to be continuously complied with by the issuers for continued listing. Such compliance is monitored by the exchanges. Failure to comply with the requirements invites suspension of trading of the security for a specified period, or withdrawal / delisting, in addition to penalty prescribed in the SC(R)A. SEBI circular permits voluntary delisting of securities from non-regional stock exchanges after providing an exit opportunity to holders of securities in the region where the concerned exchange is located. Thus a security can not be delisted from a regional exchange. An exchange can, however, delist the securities compulsorily following a very stringent procedure.

This arrangement has the following implications:

(i) Under the current dispensation, while it is mandatory to list a security on a regional exchange, it can be listed on any number of exchanges. The issuer has option to list its securities on any one or more of the exchanges. Unless the regional exchange agrees to list a security, it can not be listed on any other exchange. The issue fails if the regional exchange refuses listing. The issue also fails if any of the exchanges, to which application for listing has been made, refuses to list the security. This arrangement generates unhealthy competition. There is a competition among the issuers to list securities on as many exchanges as possible to attract investors from all over the country and waste resources to comply with the listing requirements of a number of exchanges simultaneously. Similarly there is a competition among the exchanges to attract as many issuers as possible at times leading to dilution of listing standards particularly when listing constitutes a major source of income for many of them.

(ii) A corollary to the above is that there is a lot of avoidable waste. For all practical purposes, listing agreement is a one sided agreement, rather an undertaking, requiring the issuer to agree to all the conditions prescribed at the time of signing the agreement or to be prescribed subsequently. The agreement is also amended unilaterally. The issuer has absolutely no choice in the matter as none of the terms is negotiable. The issuer is deemed to have agreed to comply with anything that may be prescribed at any time in future. Even the stock exchange does not have any freedom to vary any of the terms of the agreement. Why should we call it an agreement if both the parties to it have to blindly abide by it? Why should there be separate agreements for each security if it is the same agreement? Why should an issuer sign the same agreement with a number of exchanges? Or why should the request for listing be considered by different exchanges separately? Why should a company comply with listing agreement with different exchanges? Or why should a number of exchanges monitor compliance by a company? There are about 10,000 companies listed on Indian exchanges. Assuming that each company is listed on average on four exchanges (BSE has 9,810 listed companies as against 1,812 primary listings at the end of March 2001), there are 40,000 compliances by companies and the exchanges monitor 40,000 companies. It is just a waste of resources, as the terms are uniform across securities and across exchanges. These wastages can be avoided if the issuers of securities are asked to comply with a standard set of requirements with a third entity so that duplication/ triplication of efforts in terms of processing of request for listing, signing of listing agreement, multiple compliances by companies and multiple monitoring by exchanges are avoided.

(iii) Every exchange exercises powers of listing/denial of listing, suspending/ delisting of securities independently. As a result, a security not found suitable for listing on an exchange gets listed on a different exchange, as they follow different criteria for listing a security. It may be noted that though the criteria for listing of securities differ across exchanges, the compliance requirements are essentially same. A prospective issuer informally gets a feedback from an exchange if the latter would consider listing of his security favourably. If he does not get an encouraging response, he tries his luck with other lenient exchanges. This creates an anomalous situation that a security, which is not suitable for investors in one locality, is suitable for investors in another locality. A security should either be suitable for listing on all exchanges or not suitable at all for listing on any exchange, that is, it should be suitable for all investors or not for any. Similarly, securities can be delisted by the company from all exchanges except the regional exchange. This means that the investors living in the locality of the regional exchange are closer than those living in other locations to the hearts of regulators. Thus we have an anomalous situation where an exchange lists/suspends/delists a particular security, while other exchanges do not do so.

This anomaly came up for consideration before the Securities Appellate Tribunal (SAT) in an appeal (Lunkad Media and Entertainment Limited Vs. The Stock Exchange, Mumbai). In order to take care of such anomalies, the SAT suggested government and SEBI to consider the feasibility of providing a centralised mechanism to grant listing of securities on the stock exchanges. It felt that some sort of uniformity in deciding application for listing by exchanges would be in the interest of investors. It observed: "It does not stand to reason that a public issue found unacceptable by one exchange for the reason that the issuer company's credibility is doubtful, is acceptable to another exchange, though both the exchanges are supposed to be concerned about the interests of the investors. Investor protection measures should not be confined to territorial jurisdiction of exchanges. It should be at national level. Decision by a centralised set up may perhaps help to provide transparency and also help to maintain consistency and uniformity in the field of listing."

Conclusion

In view of the foregoing, it is desirable that there is only one agency which considers all requests for listing and grants listing if it finds a security suitable for investors across the country. A security granted listing by the agency would be available for trading on all exchanges who will not waste resources in terms of duplication of efforts on listing and monitoring compliance. The security should also be monitored, and suspended and withdrawn from trading centrally by the listing agency. All the decisions of the agency relating to listing, suspension from trading, delisting etc. should be appellable to SAT. The investors and market participants would get all the company related information, which are mandatorily required to be filed by companies, at one central location preferably a web site maintained by the CLA. The exchanges should concentrate on trading only while pre-trading activity (listing and compliance of terms of listing) is managed by CLA and post trading activity (clearing and settlement of trades) is managed by clearing corporations. The CLA should be another intermediary like clearing corporation or depository and subject to regulatory discipline of SEBI. The government circular requiring listing on a regional exchange needs to be withdrawn and all listing functions have to be vested in CLA by another circular. The listing agreement should be replaced by a two-line undertaking by a listed company to the CLA that it would comply with the applicable listing standards/requirements as amended from time to time.

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