

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

EXIT ORDER IN RESPECT OF HYDERABAD SECURITIES AND ENTERPRISES  
LIMITED (ERSTWHILE HYDERABAD STOCK EXCHANGE)

1. The Central Government had granted recognition to the Hyderabad Stock Exchange Limited, (hereinafter referred to as '**HSE**'), as a Stock Exchange under Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as '**SCRA**') on September 29, 1958. The said recognition was made permanent with effect from September 29, 1983.
2. In year 2004, Section 4A and 4B of the SCRA was introduced vide the Securities Laws (Amendment) Act, 2004 to provide for corporatisation and demutualisation of stock exchanges. In compliance with these provisions of the SCRA, HSE had submitted a Scheme for Corporatisation and Demutualization (hereinafter referred as '**C and D Scheme**') on February 2, 2005 and which was subsequently approved by SEBI vide Order dated August 29, 2005
3. HSE failed to comply with the conditions of '**C and D Scheme**' approved by SEBI vide order dated August 29, 2005. Therefore the recognition of HSE as a stock exchange stood withdrawn and a formal Notification dated September 19, 2007 was issued by Central Government for the reason of failure to demutualise on or before August 28,2007.
4. Subsequent to its de-recognition, HSE had vide letter dated August 29, 2007 requested for clarification from SEBI as regards to its functioning. SEBI through its reply dated September 5, 2007 *inter alia* advised HSE not to alienate any of the Funds maintained by it as a stock exchange including the Settlement and Trade Guarantee Fund and also to transfer any monetary amount available in the Investor Protection Fund and Investor Services Fund to the SEBI Investor Protection and Education Fund. SEBI also advised HSE not to alienate any of its movable and immovable properties/assets until further directions.

5. HSE changed its name to Hyderabad Securities and Enterprises Limited (hereinafter referred to as '**HSEL**') and a fresh certificate of incorporation was issued consequent upon change of name on March 12, 2008 by Registrar of Companies, Andhra Pradesh. As the HSE failed to demutualise, the shareholders of HSEL consist of only the trading members of erstwhile HSE. This has been confirmed to SEBI by HSEL by way of undertaking.
6. Meanwhile, SEBI, with a view to ensure smooth exit of such stock exchanges, had issued Guidelines vide Circular No. MRD/DoP/SE/Cir - 36/2008 dated December 29, 2008 (hereinafter referred to as '2008 Guidelines') detailing 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. As the recognition to HSEL was withdrawn vide notification dated September 19, 2007, it was required to exit as a stock exchange by complying with the relevant laws in this regard.
7. Subsequently, on a representation received from HSEL, SEBI vide letter dated April 22, 2010 issued further guidance to HSEL, to provide exit option to investors of companies listed exclusively on HSEL. The same was not complied with by HSEL. Further, SEBI received a representation dated September 28, 2010 from HSEL in which HSEL expressed its willingness to opt for the exit process on voluntary basis, under the 2008 Guidelines.
8. In the meanwhile, HSEL on June 29, 2011 filed Writ Petition No. 18345 of 2011 before the Hon'ble High Court of Andhra Pradesh praying *inter alia* for issuance of an appropriate writ/order/direction for declaring that the delay by SEBI in not passing the Order facilitating the exit of HSEL as a stock exchange was illegal, arbitrary, unreasonable and violative of Article 14, 19(1)(g) and 21 of the Constitution of India and also for directing SEBI to pass such order immediately. The Hon'ble High Court of Andhra Pradesh passed an ex-parte order dated July 1, 2011 observing - *"There shall be a direction to the respondent (SEBI) to consider the petitioner's (HSE) representation dated 28/09/2010 and pass appropriate orders in accordance with law within a period of four weeks from the*

*date of receipt of this order.*” However, upon request made by SEBI, Hon’ble High Court of Andhra Pradesh vide order dated March 01, 2012 extended the period of four weeks to ten weeks from the date of receipt of this order.

9. As there were certain issues arising out of the 2008 Guidelines, SEBI reviewed the Guidelines for exit of stock exchanges vide Circular No. CIR/MRD/DSA/14/2012 dated May 30, 2012 (hereinafter referred to as ‘2012 Exit Circular’) detailing the conditions for exit of de-recognised/non-operational stock exchanges including treatment of assets of de-recognised exchanges and dissemination Board for companies listed exclusively on such exchange.
10. In compliance with the directions of the Hon’ble High Court of Andhra Pradesh and in light of the above mentioned 2012 exit circular, SEBI vide letter dated June 1, 2012 advised HSEL that its representation dated September 28, 2010 was accepted as an application under the circular dated May 30, 2012 and that SEBI *prima-facie* has no objection to their exit subject to their compliance with the said circular and on submission of compliance report to the satisfaction of SEBI. Further, it was advised that HSEL shall submit fresh shareholders / other approvals, required as per law to SEBI. Subsequently, shareholders of HSEL approved the proposal of exit in the Extraordinary General Meeting convened on September 25, 2012. The approval of shareholders for exit was conveyed to SEBI by HSEL through their communication dated September 27, 2012.
11. It is noted that as per the Circular dated May 30, 2012, the following conditions are required to be complied with by the de-recognised/non-operational stock exchanges for seeking an order of exit from SEBI:
  - a) Permission to distribute its assets subject to certain conditions as laid down in the 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 shall be appointed by SEBI.

- c) The quantum of assets for distribution will be available after payment of the following :
- 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 (para 6.1 of the 2012 exit circular);
  - iii. The exiting exchange shall pay the following dues to SEBI (para 6.2 of the 2012 exit circular);
    - 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;
    - The Circular also states that 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 upto 20% of its assets (after tax) towards SEBI Investor Protection and Education Fund (IPEF) taking into account, inter alia, the governance standards of the stock exchange and estimation of future liabilities. (para 5.4 of the 2012 exit circular).
- e) To facilitate the listing of exclusively listed companies on any other recognized stock exchange. The exclusively listed companies, which fail to obtain listing on any other stock exchange, will cease to be a listed company and will be moved to the dissemination board by the exiting stock exchange. Such dissemination board would be provided by a Recognised Stock Exchange. 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.(para 3 of the 2012 exit circular).

- f) The exiting entity 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 investors complaints/grievances lying with the exchange.( para 6.5 of the 2012 exit circular).
- 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. (para 4.1 of the 2012 exit circular).

12. With respect to the application of HSEL for exit, before I assess their compliance status on the conditions for exit, issues dealt by Kania Committee and which have relevance to exit are brought out below:

12.1. Kania Committee<sup>1</sup> made the following recommendation for the tax treatment of Stock Exchange post its corporatisation and demutualization :

*“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”. The Income Tax Act, 1961 was amended by Finance (No. 2) Act, 1998, w.e.f. 1-4-1999 to inter alia include the following provisions :*

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i. <sup>1</sup> SEBI constituted a Group under the Chairmanship of Justice M. H. Kania former Chief Justice of India to review and examine the issues involved in the corporatisation and demutualisation of the stock exchanges. This led to consequent amendment in SCRA..

**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);”*

13. As HSE has failed to demutualise itself and consequently failed to demutualise itself and consequently failed to comply with the proviso to Section 47(xiii) of the Income Tax Act, it has to distribute its assets in accordance with the provisions of the respective articles/ rules of the existing company and the relevant tax laws may be applicable.

14. With respect to the compliance with the conditions for exit, I note as under :

- (i) In compliance with para-11(c)(ii) above and directions of SEBI dated September 09, 2007, HSEL has in a timely manner transferred an amount of Rs. 3,09,97,440 available in its ‘Investor Protection Fund’ and ‘Investor Services Fund’ vide Demand Draft no.59523 dated 06/12/2007 amounting to Rs. 99,00,000, Demand Draft no. 59524 dated 06/12/2007 amounting to Rs. 99,00,000, Demand Draft no. 59525 dated 06/12/2007 amounting to Rs.85,60,000, Demand Draft no. 59526 dated 20/02/2008, for Rs., 26,37,440 and ‘1% security deposit’ amount of Rs. 82,76,166 available with it vide Demand draft no. 59529- dated 15.05.2008, to the SEBI IPEF.
- (ii) In compliance with para-11(c)(iii) above, HSEL has paid the necessary dues outstanding to SEBI including 10% of the listing fee and the

annual regulatory fee vide Demand draft no. 624772 dated 18.09.09 for an amount of Rs.1,00,000/-

- (iii) In compliance with para-11(c)(iii) above, HSEL has paid the outstanding registration fees amounting to Rs 17,28,600 of brokers/trading members as specified in the SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 till the date of such de-recognition. vide Demand draft nos. 722011, dated 01.01.2010 amounting to Rs.5,00,000, Demand draft nos. 722012- 722014 dated 02.01.2010 amounting to Rs.5,00,000, Demand draft no. 722017 dated 16.01.2010 amounting to Rs.4,00,000, Demand draft no.928159 dated 16.01.2010 amounting to Rs.63,600, Demand draft no.722016 dated 16.01.2010 amounting to Rs.2,65,000.
- (iv) In compliance with para-11(d) above, HSEL has contributed an amount to Rs. 1,00,00,000 vide Demand draft nos. 321424 to 321433 dated 15.01.2013 each for an amount of Rs.9,90,000 and Demand draft no. 321434, dated 15.01.2013 for an amount of Rs.1,00,000, towards SEBI IPEF.
- (v) In compliance with para-11(e) above, HSEL has shifted the following 3 companies listed exclusively on it to the dissemination Board of BSE Ltd viz, a) Pantex Geebee Fluid Power Ltd b) Kanakavarsha Securities Ltd c) CMH Tools Ltd. HSEL has paid the requisite fees in this regard as confirmed by BSE vide its communication dated December 27,2012. Further, HSEL has submitted an undertaking dated January 17,2013 to give publicity about BSE Dissemination Board.
- (vi) In compliance with para-11(f) above, HSEL has set aside funds to the tune of Rs 1,06,622 by way of FDR in order to provide for the ongoing Arbitration case between Mr MNS Bose vs DL Soni.
- (vii) As regards para 11(g) above, HSEL vide an undertaking dated January 17, 2013 has confirmed that M/s HSE Securities Ltd, a functional subsidiary is a Corporate member of NSE, BSE& MCX and are providing trading facilities to all HSE Members.

15. In terms of para-11(b) above, SEBI in consultation with HSEL appointed M/s.K Prahalad Rao & Co, as valuation agency, for Verification and Valuation of Assets

and Liabilities of HSEL. The Valuation Agency submitted the report vide their letter dated November 26, 2012. The relevant observations of the Valuation Agency and the compliances by HSEL are as under:

- (i) The Provisional Balance Sheet for the financial year 2011-12 showed a sum of Rs.2, 239 and Rs.29,860 towards the Investor Protection Fund and Investor Service Cell respectively. In this regard, HSEL made a payment of Rs.32,099 to SEBI vide Demand Draft no. 59525 dated 10/12/2012.
- (ii) The Provisional Balance Sheet for the financial year 2011-12 showed an amount of Rs 4,58,13,420 standing to the credit of the Settlement Guarantee Fund. HSEL has submitted that out of this amount, Rs.2,00,00,000 has been contributed by HSEL and thereafter the fund earned Rs. 2,14,52,055 towards interest and the contribution of shareholders towards the Fund is only Rs.43,61,365. Further HSEL has submitted an undertaking dated January 17,2013 that contribution of shareholders would be cleared before the disposal of any fixed asset.
- (iii) No dues were found to be outstanding to SEBI including 10% of the listing fee and the annual regulatory fee.
- (iv) The net assets of the HSE are Rs.13,69,00,199 as per the Book Value. The market value of the same is Rs.2,02,83,94,843. These assets include property at Somajiguda, Hyderabad, the market value of which is stated to be Rs 192, 21,83,000 in the valuation report . However the realisable value of the same has been placed at 70% of the market value i.e Rs 134, 55,00,000 by the valuer. It is observed that there are some issues relating to Urban Land Ceiling and dispute between the HSE and Kaveri Projects Ltd., regarding construction of additional floors at the Somajiguda premises.
- (v) Further, there are claims of Canara Bank against two members in dispute of TOD (Term Over Draft) availed by them, which had been guaranteed by HSE. In this regard HSEL vide an undertaking dated January 17, 2013 submitted that no liability from the said case can arise on HSEL.
- (vi) The income tax dues are estimated to be around Rs. 3,140,570. HSEL has submitted that an amount of Rs. 45,63,267 is yet to be received from the Income tax Department towards refund of TDS and Advance Tax. However HSEL has submitted an undertaking dated January 17, 2013 that the



necessary statutory dues like Income Tax would be paid by HSEL before the disposal of any Fixed Asset.

16. Apart from the above, the valuation Report submitted by the valuation agency has brought out other liabilities in the Balance Sheet of HSEL, the details of which are given below:

Particulars	Amount
Members compensation fund	81,44,461
<b>Other Liabilities:</b>	
BMC Deposit (NSE,BSE,F&O)	3,14,92,750
BMC Deposit (HSE)	3,23,820
Cubicle Deposit(Rent Advance)	7,55,000
Rental deposit from Subsidiary	14,60,000
Other deposits	35,13,671
Book Over Draft	57,018
Other Liabilities(Payment towards VRS)	2,46,593
Liabilities for Expenses(March expenses)	1,00,572
<b>Total</b>	<b>3,84,95,424</b>

- (i) The other liabilities above also contained an amount of Rs 59,986 accrued towards listing fees, which has to be transferred to SEBI. The same has been paid by HSEL vide demand draft no. 928641 dated 22.12.12.
- (ii) Member compensation fund of Rs 81,44,461 on the liability of Balance sheet was created in order to meet any bad delivery claim which may arise for transaction done by 31 members who were allotted membership in 1995 and their membership was subject to the decision of the court. As per the undertaking dated January 17, 2013, the matter has been finally disposed of by Hon'ble Supreme Court of India.
- (iii) HSEL has submitted that the other deposits of Rs.35.13 lakhs figuring in the above table, is to the credit of the defaulters Account. Claims committee is looking after the issue and the amount will be paid as per the rules and

regulations of HSEL. HSEL has given an undertaking dated January 17, 2013 to clear the above liability before the disposal of any fixed asset.

- (iv) HSEL has undertaken to settle the amounts payable to members towards BMC deposit by liquidating any assets of the company other than the fixed assets.
- (v) HSEL has given an undertaking dated January 17, 2013 that the details of cases as submitted to SEBI are the only claims / complaints lodged with them and pending before the claim settlement committee and/or various legal forums.

17. From the valuation report and undertaking dated January 17, 2013 of HSEL it is observed that all the known liability has been brought out and that there no future liability that is not known as on date. In compliance with para-12 above, HSEL has paid an amount of Rs.1,00,00,000 to SEBI for resolving investor complaints if any, pertaining to HSEL arising in future. This apart, HSEL has already transferred to SEBI IPEF an amount of Rs 3,09,97,440 available in its 'Investor Protection Fund' and 'Investor Services Fund' and an amount of Rs. 82,76,166 under '1% security deposit'. Also HSEL has paid to SEBI the outstanding registration fees amounting to Rs 17,28,600 of brokers/trading members and has transferred to SEBI an amount of Rs 59,986 accrued towards listing fees.

18. From the above I note that HSEL has complied with the conditions contained in 2012 exit circular as detailed in preceding paragraphs specifically in paragraph 14, 15, 16 and 17. Therefore, I am of the view that it is a fit case for allowing exit to HSEL (Erstwhile HSE) in terms of clause 8 of 2012 exit circular.

19. In view of the foregoing, I, therefore, in exercise of the powers conferred upon me in terms of Section 11(1), Section 11(2) (j), Section 19 of the Securities and Exchange Board of India Act, 1992 read with Section 12A of the SCRA, allow the exit of Hyderabad Securities And Enterprises Limited (Erstwhile Hyderabad Stock Exchange) as a Stock Exchange.

20. SEBI would forward a copy of the order to the Income Tax Authorities and the State Government of Andhra Pradesh intimating the exit of HSEL, for appropriate action at their end.

21. Pursuant to the above, Hyderabad Securities & Enterprises Limited or its subsidiaries (if any) may continue to function as any other corporate entity or any other normal broking entity, as the case may be, managed by its own board subject to compliance of applicable laws/regulations etc. Further, HSEL shall not use the expression "Stock Exchange" or any variant in its name or in its subsidiary's name so as to avoid any representation of present or past affiliation with the Stock Exchange, in all media including the Web.

**DATE: January 25<sup>th</sup>, 2013**

**PLACE: MUMBAI**

**RAJEEV KUMAR AGARWAL**

**WHOLE TIME MEMBER**

**SECURITIES AND EXCHANGE BOARD OF INDIA**