

COMPETITION COMMISSION OF INDIA

Case No. 67 of 2012

19/02/2013

UPSE Securities Limited

Informant

v.

National Stock Exchange of India Limited

Opposite Party

ORDER UNDER SECTION 26(2) OF THE COMPETITION ACT, 2002

The informant is a body corporate and a wholly owned subsidiary of UP Stock Exchange Limited (UPSE), a Regional Stock Exchange (RSE). The opposite party is a national level stock exchange.

2. As per informant since the operationalisation of the opposite party in 1994, the turnover of the RSEs (including UPSE) started eroding which adversely affected their operations. In 1999, the Securities and Exchange Board of India (SEBI) envisaged a route to rescue the RSEs. The suggested route required the RSEs to form a subsidiary company. This subsidiary was permitted to acquire membership of stock exchanges such as NSE (the opposite party), BSE (Bombay Stock Exchange) etc. and the members of the RSEs could obtain sub-brokership of the subsidiary company and could trade there. UPSE accordingly formed a subsidiary (the informant) in the year 2000 and obtained membership of BSE. In response to the constant demand from its members, the informant obtained membership of NSE in 2009 by paying a high deposit (Rs. 2.71 crores) to enable the members of UPSE to trade at the opposite party stock exchange as sub brokers.

3. Briefly stated, the informant is aggrieved by an alleged excessive and discriminatory deposit structure imposed by opposite party for membership upon subsidiaries of RSEs (informant) *vis-à-vis* other corporate members. Besides the higher deposit amount, other alleged discriminatory stringent conditions imposed on subsidiaries (including the informant) of RSEs in comparison to other corporate members are, *inter alia*, as under:

- a) Subsidiaries can't do business in their own name/account, while other corporate members can do share trading on their own account.

- b) In case of a subsidiary, only a sub-broker who himself is a member of the RSE can trade, whereas in case of other corporate members, any sub broker of that corporate member can trade.
- c) A subsidiary is not permitted to allow 'Authorized Persons' to trade on its account unless such person is registered with opposite party stock exchange, whereas other corporate members are permitted to allow 'Authorized Persons' to trade on their own account, even if they are not registered with SEBI at all.
- d) Dual membership of sub-brokers of subsidiary requires base minimum capital at the level of RSE and subsidiary, whereas in case of a sub-broker of other corporate members, deposit of minimum base capital is not required.

4. These conditions, according to the informant, were discriminatory and amounted to abuse of dominant position by the opposite party in the securities market. Therefore, the informant has prayed the Commission to initiate an investigation under section 26(1) to scrutinize the conduct of the opposite party under section 4 of the Act.

5. The Commission has considered the submissions and materials provided by the parties. The definition of relevant market proposed by the informant viz 'securities market in India' seems to be correct. It may be relevant here to note that the Commission had held opposite party to be dominant in the 'Currency Derivative segment in India' in an earlier case [*MCX Stock Exchange Ltd. & Ors. v. National Stock Exchange of India Ltd. & Ors (13 of 2009)*]. Though the relevant market is much broader in this case, the assessment done in that case and the information available in the public domain indicates that opposite party was a dominant player in 'securities market in India' as well, considering its market share, size & resources, its economic power, advantage over competitors, absence of countervailing buying power and existence of entry barriers etc.

6. Unlike the Monopolies and Restrictive Trade Practices Act, 1969, dominance in itself is not prohibited by the Competition Act, 2002. It is only abuse of dominance which the Act intends to proscribe. Undoubtedly, the opposite party treated the RSE members (including informant) differently from other corporate members. However, differential treatment in itself cannot always be discriminatory. The notion of equality enshrined under the Indian Constitution recognizes reasonable classification and conceives different treatment may be accorded to different classes. There are significant differences, as explained by the opposite

party, between ordinary corporate members and RSE members wishing to obtain membership of the opposite party stock exchange. In particular the differences in the risk posed by each of them to the financial system. Securities and Exchange Board of India (SEBI) itself recognized this difference and has provided for a stricter regulatory regime for RSE members. Further, SEBI's and opposite party's decision to permit RSEs to obtain their membership was aimed at the revival of regional stock exchanges. Membership at the opposite party stock exchange was open to different categories of persons who fulfilled the eligibility criterion laid down by SEBI and opposite party. For purposes of risk assessment, opposite party treated individuals and partnership firms as one class of members, ordinary corporate members as another class of members, and RSEs as a third class of members. Market integrity was the essence of any financial market and therefore, to pre-empt market failures and protect investors, SEBI and the stock exchanges developed a comprehensive risk management system, which was constantly monitored and upgraded. It encompassed capital adequacy of members, deposit and adequate margin requirements, limits on exposure and turnover, indemnity insurance, on-line position monitoring and automatic disablement, etc. The RSE members and other corporate members differed from each other in terms of composition and business.

7. An ordinary corporate member could carry out proprietary trades on the opposite party stock exchange as well as trades on behalf of sub-brokers/clients. Whereas, an RSE Member (like informant) was a special purpose vehicle established as a subsidiary of a regional stock exchange. Such RSE subsidiary was prohibited by SEBI from undertaking any dealing in securities on its own account and its only source of income could be brokerage fees collected for trades on the nationwide stock exchange of which it was a member. It is also relevant to be noted that it is not the RSE Member who competes with the ordinary corporate member on the stock exchange, but the members of the RSE registered as sub-brokers of the RSE Members compete with corporate members. The RSE Member structure is only a methodology adopted by SEBI to allow for the revival of RSEs and permit the members of RSEs to trade on opposite party stock exchange by registering themselves as sub-brokers of the RSE Member. In the absence of this scheme, the members of the RSE, had they wished to trade on opposite party stock exchange, would have had to obtain its direct membership. In the case of an ordinary corporate member, opposite party grants membership to one corporate entity, whereas, in the case of granting an RSE Member right to trade, opposite party was

granting indirect membership to many members of the RSE who would otherwise had to directly obtain its membership by paying the deposit fee.

8. Another important difference between ordinary corporate members and RSE member lies in the liability for paying shortfall in the margins to the opposite party stock exchange. In case of shortfall in the margins payable to the stock exchanges (like opposite party), an ordinary corporate member is directly liable to meet the shortfall to opposite party, whereas the RSE Member has to necessarily collect the shortfall from its sub-brokers to pay to the opposite party. This is because, under the spirit of the SEBI regulations governing RSE Members, the RSE Members can neither use their own money, nor the money of the parent RSE to cover any shortfall. SEBI mandates that RSE Members trading limits/exposure of a sub-broker shall be based on the deposit received by the RSE Member. Therefore, the RSE subsidiary would have to collect margins from sub-brokers in order to make a trade on the national exchange. Such a back-to-back margin requirement imposed on RSE Members was to ensure that they do not trade on their own account and do not utilize any of their own funds to complete trades.

9. In addition to this, all trades entered, but not completed, involving other sub-brokers of the RSE Member was also at risk and the opposite party was required to compensate all clients of the RSE Member for trades that did not complete. The stringent requirements on the opposite party were necessary to ensure investor protection, and the risks involved in allowing RSE Members to trade on its exchange without being able to access external funds as in the case of ordinary corporate members. This also justified the higher deposit requirements imposed on RSE Member by opposite party.

10. In view of the foregoing, it appears that the conditions imposed by opposite party on RSE members (including informant) were necessary for investors' protection. Transactions between opposite party and ordinary corporate members on one hand, and between opposite party and RSE Members on the other were therefore not comparable. The opposite party's conduct therefore does not seem to be in contravention of the provisions of the Act.

11. On the basis of aforesaid, the Commission is of the view that there does not exist a *prima facie* case under section 4 of the Act. The case deserves to be closed under section 26 (2) of the Act and is accordingly hereby closed.

12. The Secretary is directed to communicate the decision of the Commission to all concerned accordingly.

Sd/-
(H.C. Gupta)
Member

Sd/-
(R. Prasad)
Member

Sd/-
(Geeta Gouri)
Member

Sd/-
(Anurag Goel)
Member

Sd/-
(M.L. Tayal)
Member

Sd/-
(Justice S.N. Dhingra) {Retd.)
Member

Sd/-
(Ashoka Chawla)
Chairperson