

Parliament Approves

Stock Exchanges - Demutualization



*Comments on the Stock Exchanges (Corporatisation,
Demutnalization and Integration) Act, 2009.*

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Executive Summary

SECP's – Securities and Exchange Commission of Pakistan ('the Commission') initiative to bring about structural and regulatory changes through legal reforms through The Stock Exchanges (Corporatisation¹, Demutualization² and Integration³) Act, 2009 has been approved in a joint session of Parliament on March 27, 2012 and enacted into law by President on May 7, 2012.

The salient features of this Act are as under:

- the stock exchanges' structure from non-profit, mutually owned organizations would be converted to for-profit entities owned by shareholders;
- demutualization should be completed within 119 days of its promulgation;
- Upon re-registration from a company limited by guarantee to a public company limited by shares, the directors of the stock exchange holding office on the date of demutualization will automatically cease to hold such office and would stand replaced by the first directors of the newly incorporated company;
- The demutualization would be binding on all persons and authorities having any contractual or statutory, right, power, obligation or liability in connection with the stock exchange;
- Shares of a stock exchange would be listed, on any stock exchange in consultation with the board of directors of the stock exchange which is to be listed. However, where the shares of a stock exchange are to be listed on itself, the Commission will act as the front line regulator of such stock exchange for such listing;
- Two or more stock exchanges may integrate complying with the following procedure:
 - Prepare a scheme of integration
 - Get the scheme approved by a special resolution of the shareholders of each stock exchange,
 - Complete such procedures as prescribed by the Commission,
 - Apply for approval of scheme by the Commission,



- Publish the scheme in two daily newspapers having national coverage seeking intimation in writing, directly to the Commission, within 15 days from the stakeholders regarding any reason as to why the scheme may not be approved.
- This statute further provides for various regulations for operating as brokers whereby on Corporate entities can only operate as brokers after demutualization. While a TRE certificate holder registered as broker can convert itself into corporate entity after one year from the commencement of this Act provided if they meet the specified criteria.
- The law also provides for rights attached to shares in blocked account, procedure for election of board of directors of stock exchange after demutualization, divestment and issue of further shares, share and purchase of shares by strategic investor and financial institution, listing of shares, Trading Rights, etc.
- In addition to the above, the stock exchanges cannot initiate the following without the prior approval of the Commission:
 - Amend the Memorandum and Articles of Association;
 - Wound up the stock exchange; and
 - Sell assets of the stock exchange.
- This Act also provides for various penalties in case of offence/contravention.



The Commission seeks to extend this Act to whole of Pakistan and the same shall come into force at once.

Stock Exchanges (Corporatisation, Demutualization and Integration) Act, 2009

DEMUTUALIZATION COMMITTEE (Section 3)

According to this section the members of stock exchange are required, within thirty days from the commencement of this Act, to form a Demutualization Committee which shall be authorized to:

- approve the valuation of the stock exchange to be undertaken by an investment bank;
- enter into negotiations and finalize the sale of not more than forty percent (40%) of the total issued share capital out of the shares lying in the blocked account⁴ with any one or more strategic investors⁵ or financial institutions; and
- determine the offer price for sale of shares to general public.

The Committee is empowered to accept any price that is equal to or greater than the valuation carried out under section 4. In case the price offered is less than the approved valuation, decision for the acceptance of offer will be made in a meeting of the initial shareholders of the stock exchange through a majority vote, unless the members while constituting the committee gave such authority to the committee.

Section 4

Each stock exchange is required to submit the following documents to the Commission within forty five (45) days of the commencement of this Act:

- a valuation, to be provided in a sealed envelope to the Commission, of the stock exchange approved by the committee as at any date that may be specified by the Commission, based on the discounted cash flow or net asset value of the stock exchange, or any other internationally accepted method of valuation undertaken by a renowned international investment bank approved by the Commission;



Relaxation:

Upon a reasonable request made by the stock exchange, time for the submission of valuation may be extended by the Commission upto one hundred and twenty days (120) from the commencement of this Act.

- a revaluation of the assets and liabilities of the stock exchange as at 30th June, 2008, or any other date specified by the Commission, undertaken by a firm of Chartered Accountants approved by the Commission in accordance with the prescribed criteria based on which valuation, the number of shares of ten (10) rupees par value proposed to be issued will be determined;
- the proposed authorized and paid-up capital of the stock exchange with the number of shares to be issued;
- the names of members of the stock exchange proposed to be the initial shareholders of the stock exchange and the number and value of shares to be allotted, for consideration other than cash, to each such member;
- the names of four members of the stock exchange, nominated to act as the first directors of the stock exchange until such time till election of directors are held in accordance with this Act;
- the proposed plan for the segregation of the commercial and regulatory functions of the stock exchange;
- the draft memorandum and articles of association of the stock exchange; and
- a detailed five year development plan for the stock exchange together with the capital expenditure estimate and the sources of finance.

All the items, except for valuation, shall be submitted to the Commission after being duly approved by the Board of Directors of the stock exchange.

On receipt of the items listed above the Commission will, within thirty (30) days of receipt such items, subject to the provisions of sub-section (4) of section 4, approve and communicate the said items to the stock exchange.



Section 4(4)

“The Commission, if it deems necessary in the interest of the capital markets, make appropriate amendments in any of the matters mentioned in sub-section (2) of section 4, other than the re-valuation carried out by the firm of Chartered Accountants, before granting its approval.”

Provided that before marking any substantive amendments, the Commission shall inform the stock exchange of such amendments, and if so required by the stock exchange in writing, provide an opportunity of hearing to the stock exchange.

Provided, further that any decision of the Commission under this sub-section shall be final and binding.

AFTER GRANT OF APPROVAL

The stock exchange is, within thirty (30) days of grant of approval from the Commission, required to do the following:

- adopt in a meeting of its members by a special resolution the approved memorandum and articles of association;
- allot shares, in a dematerialized format which shall not be convertible into physical format, to the members approved to be the initial shareholders in the approved numbers;
- deposit in a blocked account sixty percent (60%) of shares allotted to each initial shareholder and hold these in the blocked account until such time as these shares are disposed off in accordance with section 12;
- issue a certificate to each initial shareholder specifying the number of his shares held in the blocked account; and
- issue a TRE certificate⁶ to each initial shareholder.

Further, within seven days of the adoption of the memorandum and articles of association as aforesaid, the stock exchange shall deliver to the Registrar:

- (a) a certified copy of the special resolution by which the memorandum and articles of association have been adopted;
- (b) a certificate from the auditors of the stock exchange certifying that all shares have been allotted to the initial shareholders in a dematerialized format, and



- (c) a certificate from CDC that sixty percent of the shares allotted to each initial shareholder have been deposited in a blocked account in accordance with clause (c) of sub-section (1) of section 5.

ISSUANCE OF RE-REGISTRATION CERTIFICATE BY THE REGISTRAR

As per section 6 the Registrar, after confirmation from the Commission, will issue a certificate of re-registration to the stock exchange within seven days of receipt of the information mentioned in sub-section (3) of section 5. The certificate shall be prima facie evidence of stock exchange's change in status from a company limited by guarantee to a public company limited by shares.

On the date of receipt of the certificate, the directors of the stock exchange holding office will automatically cease to hold such office and will be replaced by the first directors.

EFFECTS OF CORPORATISATION (Section 7)

Upon corporatisation, all the assets and liabilities of the stock exchange as at the date of corporatisation will remain the same. Further, the corporatisation of the stock exchange will not:

- (a) create a new legal entity or prejudice or affect identity or continuity of the stock exchange;
- (b) adversely affect the registration of the stock exchange under section 5 of the Securities Ordinance;
- (c) prejudice or affect the continuity of undertakings of stock exchange;
- (d) render defective or affect any legal, disciplinary or other proceedings brought by or against the stock exchange prior to the date of corporatisation;
- (e) affect the validity of any regulation made by the stock exchange or the Commission in pursuance of section 34 of the Securities Ordinance;
- (f) affect any instruction, order, approval, notification, direction, act, requirement, condition, consent, guideline, circular, undertaking, declaration, indemnity, waiver, exemption, restriction or decision or other document howsoever called, made, given or done by the stock exchange or the commission in accordance with or in pursuance of the Companies Ordinance or the Securities Ordinance or any other law or rules and regulations made under such law in force at the date of corporatisation, and such instruction, order, approval, notification, direction, act, requirement, condition, consent, guideline, circular, undertaking, declaration, indemnity, waiver exemption, restriction or derision or other document shall remain valid, binding and have effect in relation to the persons to whom such instruction, order, approval, notification, direction, act, requirement, condition, consent, guideline, circular, undertaking, declaration, indemnity, waiver, exemption, restriction or decision is applied until it is amended repeated or otherwise expires;



- (g) affect any right, privilege, obligation or liability acquired by or accrued to the stock exchange under the provisions of the Companies Ordinance or the Securities Ordinance or any other law or rules and regulations made under any such law in force at the date of corporatisation and shall not affect any legal, disciplinary or other proceedings, remedy inspection, investigation or inquiry in relation to such right, privilege, obligation or liability and any such legal, disciplinary or other proceedings, remedy, inspection, investigation or inquiry may be instituted, continued or enforced after the date of corporatisation; and
- (h) affect any action that has been taken by the stock exchange for any breach of its regulations.

Further, upon corporatisation the liability of each member of the stock exchange as guarantor shall be deemed to be extinguished immediately.

Section 8

After fulfillment of all the requirements of corporatisation, the stock exchange shall stand demutualized.

RIGHTS ATTACHED TO SHARES IN BLOCKED ACCOUNT (Section 9)

The blocked account shall be operated by the directors in the manner prescribed by the Commission and the rights in respect of the sixty percent (60%) shares of **each initial shareholder deposited** in the blocked account will vest and be exercised in the following manner, namely:

- (a) the right to receive dividends, bonus shares, rights shares and the proceeds of sale of these shares will vest in the initial shareholders:

Provided that the bonus shares and right shares if any, shall be added to the blocked shares of the initial shareholder and shall be disposed of along with those blocked shares in the manner provided in this Act;

- (b) the right to sell these shares shall vest in the stock exchange to be exercised in the manner provided in section 12; and
- (c) the right to exercise the voting power attached to these shares shall remain suspended till the time of sale of these shares in accordance with section 12.



ELECTIONS OF BOARD OF DIRECTORS OF STOCK EXCHANGE AFTER DEMUTUALIZATION (Section 10)

The stock exchange is required to hold elections of directors within thirty (30) days from the date of demutualization.

The aforesaid elections will only be in respect of seats acquired by first directors nominated by the stock exchange, the nominees of the Commission will continue to hold office until the Commission directs for their replacement.

There is a restriction that TRE certificate holders or their connected persons⁷ cannot:

- hold the majority on the BOD of the stock exchange;
- hold more than forty percent (40%) of the total paid up capital of the stock exchange; and
- become the Chairman of the Board of stock exchange.

EFFECT OF DEMUTUALIZATION (Section 11)

The demutualization shall not adversely affect the registration of the stock exchange under section 5 of the Securities Ordinance. Further, the demutualization of the stock exchange shall become binding on all persons and authorities having any contractual or statutory, right, power, obligation or liability in connection with the stock exchange.

DIVESTMENT AND ISSUE OF FURTHER SHARES BY THE STOCK EXCHANGE (Section 12)

Divestment (Section 12(1))

Within two years of demutualization, the Commission is empowered to direct the stock exchange and its shareholders to do one or more of the following:

- (a) to enter into an agreement with a strategic investor, within one year of such direction, for the sale of not more than forty percent (40%) of its total issued share capital out of the shares lying in the blocked account;

If no agreement for the sale of shares of the stock exchange is reached with any strategic investor within one year of the direction given by the Commission, the Commission may open the sealed envelop containing the valuation of the shares and may take such steps or give such directions which may be necessary for achieving the sale of shares, including but not limited to:



- ordering the sale of shares to a strategic investor who had earlier made an offer to purchase the shares, if the price offered by such strategic investor was equal or more than the valuation of the shares Contained in the envelop;
 - ordering a fresh auction of the shares and selling to the highest bidding strategic investor or financial institutions such number of shares and in such manner specified by the Commission; or
 - ordering a revaluation of the stock exchange a at the cost of the stock exchange in such manner specified by the Commission.
- (b) to sell to the general public through an offer for sale, not less twenty percent (20%) of its total issued capital out of the shares lying direction in accordance with the applicable laws; and
- (c) to enter into agreements with and to sell to local financial institutions any shares remaining in the blocked account after sale of shares to the strategic investor and the general public, within one year of the direction.

The Commission may extend the period for compliance upon an application by the stock exchange setting out the reasons for not being able to comply with the said order within the specified time.

Issue of Further Shares (Section 12(2))

This section provides that a stock exchange may issue further capital, by special resolution with the prior written approval of the Commission, carrying extra voting rights to a strategic investor.

SALE AND PURCHASE OF SHARES BY STRATEGIC INVESTOR AND FINANCIAL INSTITUTION (Section 13)

Sale of Shares (Section 13(1))

A strategic investor or a financial institution acquiring shares under section 12 may sell its shareholding in a stock exchange only to another strategic investor or a financial institution as the case may be, with the prior written approval of the Commission.

Purchase of Shares (Section 13(1))

A strategic investor may acquire further shares of a stock exchange in which it is a strategic investor to enable it to increase its shareholding up to fifty one percent (51%) of the total paid up capital, subject to the following conditions:



- (a) the prior approval of the Commission is obtained for such further acquisition of shares;
- (b) the further acquisition is made not less than three years after it acquires shares under section 12; and
- (c) the shares are purchased from the market by making a public offer in a transparent manner.

Restriction on Financial Institutions (Section 13(3))

The law renders strict restriction on financial institution, who has acquired shares pursuant to section 12, upon acquisition of any further shares from the general public. However, the financial institution may acquire further shares from another financial institution subject to prior approval of the Commission.

Relaxation:

The Commission may relax the any or all of the restrictions on strategic investor and financial institution by an order and reasons to be recorded in writing after four years of demutualization.

Non Applicability:

The provisions of the Listed Companies (Substantial Acquisition of Voting Shares and Takeovers) Ordinance, 2002 (CIII of 2002) are not applicable to any acquisition of voting shares of a stock exchange by a strategic investor.

POWER OF THE COMMISSION TO REQUIRE DIVESTMENT (Section 14)

- ⇒ an initial shareholder;
- ⇒ a member of the general public (including a company); or
- ⇒ a TRE certificate holder

directly or indirectly (acquired by a connected person of such person) acquires more than one percent (1%) of the shares of a stock exchange, the Commission may direct such person to



divest these shares in a manner specified by the Commission from time to time or case to case basis.

Further, if a financial institution, other than a financial institution acquiring shares under section 12, directly or indirectly (acquired by a connected person of such financial institution) acquires more than five percent (5%) of the shares of a stock exchange, the Commission may direct such financial institution to divest these shares in a manner specified by the Commission from time to time or on a case to case basis.

LISTING OF SHARES (Section 15)

This section provides that the shares of a demutualized stock exchange may be listed on any stock exchange within the time prescribed by the Commission after consulting with the board of directors of the stock exchange which is to be listed.

Self Listing (Section 15(2))

As per this section, the shares of the stock exchange may be listed on itself, subject to the condition that the Commission will act as a front line regulator and administrator for such listing of stock exchange. Self listing may be initiated in the following manner:

- submission of an application of self listing by the stock exchange, in the form and manner prescribed by the Commission; and
- the Commission, upon receipt of the above application, if satisfied and after making necessary inquiries order the listing of shares.

TRADING RIGHTS (Section 16)

An initial shareholder who is issued a TRE certificate under section 5 will, if not already registered as a broker with the Commission, be entitled to be so registered not later than two years from the date of demutualization provided that he meets the fit and proper criteria. Such TRE certificate holder shall commence business within six (6) months from the date of registration as a broker.

Further, a TRE certificate issued under section 5 will be transferable only once in the prescribed manner on prescribed form and such transfer by a registered broker will result in the cancellation of his registration as a broker.

Any fit and proper person acquiring a TRE certificate from an initial shareholder, in the above mentioned manner, shall get himself registered as a broker within six (6) months from



the date of acquiring the certificate, and shall commence business not later than twelve (12) months from the date of such acquisition.

Restrictions:

(Section 16 (4))

A stock exchange shall not issue new TRE certificates to any person until 30th June, 2010 unless two-third (2/3rd) majority of TRE certificate holders of a stock exchange decide otherwise.

(Section 16 (5))

After 1st July, 2010 till 31st December, 2019, the stock exchange can issue fifteen (15) TRE certificates each year in the prescribed manner.

(Section 16 (6))

After 2019, no such restriction shall be placed and a stock exchange may issue a TRE certificate to any person who meets the fit and proper criteria for registration as a broker.

Such person may get himself registered as a broker within six (6) months from the date of issuance of such certificate and shall commence business within three (3) months from the date of such registration.

(Section 16 (8))

After the date of demutualization, **ONLY PRIVATE COMPANY OR A PUBLIC COMPANY** as defined under the Companies Ordinance, 1984 shall be eligible to operate as a broker on stock exchange.

Any TRE certificate holder who is registered as a broker on a stock exchange on the date of commencement of this Act shall not be required to convert in to Corporate Brokerage House (a private company or a public company which is registered as a broker) till one year from the commencement of this Act.

Further all corporate brokerage houses shall comply with the provisions of Code of Corporate Governance issued by the Commission and amended from time to time.

INTEGRATION (Section 17)



This section provides that stock exchanges may be integrated, after filing a scheme of integration duly approved by a special resolution of the shareholders of the stock exchange, by an order of the Commission.

Such integration may also be done by creating a new legal entity to which the assets, undertakings and liabilities of each of the stock exchanges may be transferred. However, such new entity shall apply for registration as a stock exchange under section 5 of the Securities Ordinance.

(Section 18)

Further the Commission is empowered to approve the scheme, after making necessary inquiries as it deems fit, and upon such approval the stock exchanges shall publish the scheme in two (2) daily newspapers of national coverage, requiring the stakeholders to intimate directly to the Commission in writing, within the 15th day from the date of such publication, the reasons, if any, that why the Commission should not approve such scheme.

The Commission may, if satisfied that the requirements of the prescribed procedure have been complied with, approve the scheme of integration with such modifications, as it may deem appropriate, and specify the effective date of integration. Such scheme shall be posted on website of the Commission and published in the official Gazette. Further, the stock exchange shall also publish the approved scheme in two (2) newspapers of national coverage.

As per sub section (2) of section 18, notwithstanding anything contrary contained in any other law, the scheme of integration shall have effect and shall be binding on all persons interested in the transferor stock exchange or successor stock exchange (or the new legal entity as the case may be) including all shareholders, stakeholders and employees of the stock exchanges and all persons having an interest in any asset, undertaking or liability of either the transferor stock exchange or the successor stock exchange (or the new legal entity as the case may be).

PENALTIES (Section 19)

If the Commission is satisfied that;

- a stock exchange;
- a director of a stock exchange;
- committee member;
- shareholder;
- TRE certificate holder; or
- any other person



is guilty of an offence under this Act or has contravened any provisions of this Act or the regulations hereunder, the Commission may provide a reasonable opportunity of hearing to the above mentioned persons. And if after giving the reasonable opportunity the Commission is satisfied that any of the aforementioned persons willfully committed an offence under this Act, and then it may impose any of the following penalties:

- suspension / cancellation of the registration of the stock exceeding or payment of a sum not exceeding twenty (20) million rupees by the stock exchange;
- suspension / removal from the Board of the stock exchange of director(s) responsible for such failure or payment of a sum not exceeding one million rupees by director(s) responsible for such failure;
- payment of a sum of one (1) million rupees from each shareholder / TRE certificate holder / committee member guilty of an offence under this Act.

The afore mentioned payments shall be recoverable by the Commission as arrears of land revenue.

AMMENDMENTS IN MEMORANDUM AND ARTICLES OF ASSOCIATION (Section 20)

The stock exchange is restricted from making any amendments to its memorandum and articles of association without prior approval if the Commission.

WINDING UP (Section 21)

Under this section the stock exchange is restricted from commencing any proceedings for winding up, whether voluntary or otherwise, without prior approval of the Commission. However the Commission is empowered to take necessary steps to rehabilitate the stock exchange facing financial or operational crisis.

PROHIBITION ON SALE ETC. ON ASSETS OF THE STOCK EXCHANGE (Section 22)

A stock exchange shall not sell immovable assets owned by the stock exchange at the date of corporatisation without the prior approval of the Commission and the stock exchange shall ensure that all assets are utilized in furtherance of the business of the stock exchange.

REMOVAL OF ANY DIFFICULTY (Section 27)

In case if any difficulty arises in giving effect to the provisions of this Act, the Federal Government may, not inconsistent, with the provisions of this Act, give such directions as it may consider necessary for the removal of such difficulty.



1	Corporatisation	the conversion of a stock exchange from a company limited by guarantee to public company limited by shares.
2	Demutualization	the segregation of the majority ownership of a stock exchange from the right to trade on such stock exchange.
3	Integration	the merger of two or more stock exchanges.
4	Blocked Account	a CDC account established by a stock exchange in accordance with clause (c) of sub-section (1) of section 5.
5	Strategic Investor	a stock exchange, depository company, a derivative exchange or a clearing house which has been approved by the Commission in accordance with the prescribed criteria, for the purposes of acquiring shares of a stock exchange in pursuance of section 12.
6	TRE Certificate	Trading Right Entitlement Certificate means a certificate issued by a stock exchange evidencing right of the TRE certificate holder to apply for registration as a broker in accordance with the Broker and Agent Registration Rules, 2001 as amended from time to time.
7	Connected person	in relation to a natural person, a spouse, real, step or half sibling, lineal ascendant or descendant of such person, a partner, promoter or substantial shareholder of an undertaking, company or body corporate in which such person is also a partner, promoter or substantial shareholder or an undertaking, company or body corporate in which such person is a partner, promoter, substantial shareholder or director, in relation to a legal person a Connected person means an undertaking, company or body corporate which is a holding or associated company of such legal person.