

Scheme for Demutualisation



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The Calcutta Stock Exchange Association Ltd

7, Lyons Range
Kolkata – 700 001

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1. Introduction

1.1. History

From a get together under a "**Neem Tree**" way back in early 19th century, the Calcutta Stock broking fraternity has come a long way. Though the once famous shelter for Calcutta Stock brokers no longer exists, the roots laid in the last century have dug themselves deep into the city and the region.

By 1830 there was a perceptible increase in the volume of business in Calcutta and we find in the 'Englishman' of 1836, the then widely circulated newspaper from Calcutta quotations of 4%, 5% and 6% loans of the East India company as well as shares of the Bank of Bengal being quoted at a considerable high premium over the par value of Rs. 100/-. Three years later, in 1839, quotations were also found in newspapers published from Calcutta, of shares of the Union Bank, the Agra Bank and certain other commercial undertakings like Bengal Bonded Warehouse Docking Company and Steam Tug Company.

The advent of the Companies Act 1850 and the subsequent introduction of the principle of limited liability, made investments in stocks and shares popular. In May 1908, an association was formed under the name and style of the **Calcutta Stock Exchange Association** at 2, China Bazar Street. On June 7, 1923 the Association was registered as a limited liability concern, with an authorised capital of Rs. 3 lakhs divided into 300 shares of Rs. 1,000/- each. The shares were subdivided into 4 shares of Rs. 250/- each in 1959.

At the time of incorporation in 1908, the Stock Exchange had 150 members. Today the total membership has risen to more than 900, which contains several corporate and institutional members. The number of companies listed on the Exchange is more than 3,500. The Calcutta Stock

Exchange has been granted permanent recognition by the Central Government with effect from April 14, 1980 under the relevant provisions of the Securities Contracts (Regulation) Act, 1956, with a view to render useful service to investors.

On 26th February, 1997 the Calcutta Stock Exchange ushered in a new era by replacing the old manual trading system with completely computerised on-line trading & reporting system known as **C-STAR (CSE Screen based Trading And Reporting)**.

1.2. Guideline

The Finance Minister in his Budget Speech for the year 2002-03 announced for Corporatisation and Demutualisation of Stock Exchanges by which ownership and trading right would be separated from each other.

To implement the said policy of the Government, Securities and Exchange Board Of India constituted a group under the Chairmanship of former Chief Justice of India , Sri M.H. Kania and the recommendation of the group were as follows :

- The three stakeholders viz. shareholders, brokers and investing public through the regulatory body should be equally represented on the governing board of the demutualised stock exchange;
- There should be specific vacancies on the board for each group of stakeholders;
- The shareholders' representatives should not be functioning brokers;
- The brokers representatives would be elected by the shareholders from among the brokers of the stock exchange;

- The representatives of the investing public would be nominated by SEBI from among a panel comprising of academicians, professionals, industry representatives, public figures and investors association, none of whom should have any interest in any broking firm;
- Adequate disclosures about the background of the directors of the board should be provided to the shareholders at the annual general meetings and the annual reports;
- The maximum number of directors on the board to be governed by the relevant provisions of the Companies Act. 1956; and
- Current restrictions on the tenure of broker directors should continue.

The report of the Group along with public comments was considered by the Board of SEBI and was approved subject to certain conditions. Such conditions are:

- The existing members of the stock exchange will get shares in the demutualised entity, but whether they will have voting rights or not, is yet to be determined by SEBI in consultation with the Central Government.
- The names of all directors (including broker directors) will be subject to prior approval of SEBI. The tenure of different categories of directors is yet to be determined by SEBI.

1.3. Plan Objective

To expedite the process of Corporatisation and Demutualisation of the Exchanges, SEBI had advised all Stock Exchanges to formulate Scheme for Corporatisation and Demutualisation on the basis of recommendations of

Justice Kania Committee and submit the same to SEBI within 30th July 2003 for its approval and subsequent implementation.

The Calcutta Stock Exchange Association Limited is a Company limited by shares, and therefore is already Corporatised. In view of the above,

Calcutta Stock Exchange has finalised the “Scheme for Demutualisation” for its submission to SEBI within the stipulated deadline. Upon approval of the scheme by SEBI, The Calcutta Stock Exchange Association Limited will implement the same within the scheduled time frame.

2. Definition

In this Scheme, unless the otherwise stated :

- i. **“CSEA Ltd”** shall mean **The Calcutta Stock Exchange Association Limited**, the Company incorporated under The Companies Act ,1913 and having its registered office situated at 7, Lyons Range, Kolkata : 700001 and providing a market for Security trading for its members for whom the scheme for demutualisation is in process.
- ii. **“CSE Ltd”** shall mean **The Calcutta Stock Exchange Limited**, the Company having its registered office situated at 7, Lyons Range, Kolkata : 700001 and providing a market for Security trading after completion of the demutualisation process of CSEA Ltd.
- iii. **“Board of Directors”** shall mean the board of directors of CSE Ltd.
- iv. **“Stock Broker Representative”** shall mean any person who, at the time of demutualisation and thereafter is carrying on business as a stock broker in CSE Ltd. and includes a person who is a qualifying director of a Corporate member , or is in the whole time employment of such Corporate stock broker.
- v. **“Shareholder Representative”** shall mean any person who, at the time of demutualisation and thereafter is holding at least one share of CSE Ltd. and not carrying on business as a stock broker / sub broker in CSE Ltd. or related and /or interested and /or associates of a firm or a Corporate entity carrying on stock broking business.
- vi. **“Public Representative / Investor Representative”** shall mean any person who are neither Stock broker representative nor shareholder representative as stated in definition nos. **iv** & **v** above. Such person

should have adequate knowledge of Capital Market and be of public eminence.

- vii. **“Chairman”** shall mean the chairman of the Board of Director of CSE Ltd.
- viii. **“CEO”** shall mean the Chief Executive Officer of CSE Ltd.
- ix. **“SEBI”** shall mean the Securities and Exchange Board of India established under the Securities and Exchange Board of India Act, 1992.
- x. **“Effective Date”** means the date on which the Scheme of Demutualisation of CSEA Ltd. is approved by the SEBI.
- xi. **“Articles, Rules, Bye-Laws and Regulations”** shall mean the Memorandum and Articles of Association, Rules, Bye-Laws and regulations, of CSE Ltd.
- xii. **“Stock broker”** shall have the same meaning as is assigned thereto in Clause 2(e) of the Securities and Exchange Board of India (Stock Brokers and Sub-brokers) Rules, 1992.
- xiii. **“Sub-broker”** shall have the same meaning as is assigned thereto in Clause 2(f) the Securities and Exchange Board of India (Stock Brokers and Sub-brokers) Rules, 1992.
- xiv. **“Shareholder of CSE Ltd”** shall mean a person who holds any equity share or shares of CSE Ltd after its demutualisation. A Shareholder of CSE Ltd may or may not be a Trading Member of CSE Ltd. A Trading Member of CSE shall not be deemed to be a Shareholder of CSE merely by reason of being a Trading Member of CSE Ltd.

- xv. **“Trading Member of CSE”** shall mean a person who is a member of CSE Ltd. with trading rights, in accordance with the Rules, Bye-laws, and Regulations of CSE Ltd. A Trading Member of CSE Ltd. may or may not be a Shareholder of CSE Ltd. A Shareholder of CSE Ltd. shall not be deemed to be a Trading Member of CSE Ltd. merely by reason of holding any equity share or shares of CSE Ltd.

3. Demutualisation

3.1. Proposal

Demutualisation implies the segregation of members' (shareholders) right of CSEA Ltd into two distinct segments, viz. ownership rights and trading rights as per recommendation of Justice Kania committee. It is proposed to initiate the process of demutualisation involving de-coupling of trading & ownership rights of CSEA Ltd and constituting the Management Structure in the manner recommended.

To facilitate demutualisation of CSEA Ltd, it is essential to amend/modify the existing Memorandum & Articles of Association in accordance with the existing provisions of the Companies Act, 1956, to convert it from a non profit making Company to a profit making Corporate body, separation of ownership & trading rights of the existing members, reconstitution of Board of Directors, appointment of CEO etc as per recommendation of Justice Kania Committee. Rules, Byelaws and Regulations of the exchange also to be modified in accordance with model rules prescribed by SEBI. Valuation of its existing assets to be done to determine the intrinsic value of each share to be distributed among existing shareholders at the time of demutualisation.

3.2. Preserve Exchange interest

It has been observed that in most of the cases of demutualisation internationally, no cash consideration is paid to the members in lieu of their ownership in the old entity. Almost in all cases, the old members were allotted shares on surrender of their existing rights in the exchange.

It is further observed that any proposal of demutualisation, which directly or indirectly involves funds outflow, or distribution of money out of the corpus of the Exchange will be detrimental to the interests of the Exchange

as it will seriously deplete Exchange resources and jeopardize its existence under the present financial condition, irrespective of any lock-in period .

As demutualisation, in principle, envisages continuation and better governance of the Exchange with aim to offer a fair market-place, adoption of a model which preserves Exchange interest as it's first and foremost objective is a pre-requisite. The model, therefore, must ensure that large-scale fund outflow is avoided in the exercise of demutualisation.

A few observations in this context are as follows :

- a) The existing active trading members who are regularly participating in the equity segment of the exchange despite all odds and are trying to earn their livelihood would prefer to continue to be part of CSE Ltd (after demutualisation) and therefore, will be interested in retaining their shareholding rights instead of cash out of corpus of the Exchange. These members will continue to be both traders and shareholders in CSE Ltd.
- b) Out of the total membership of the Exchange, currently a section of members are inactive - who are not participating in trading activities of the Exchange either due to financial difficulty or otherwise, or are not willing to participate in trading due to their assessment of low opportunity of gain out of it in comparison with their existing business. Such members continue to retain the cards in expectation of appreciation of its value to gain personally, without adding any economic benefit to the Exchange or to the Indian economy. Therefore, if cash considerations (in lieu of their shareholding rights) are to be disbursed at the time of demutualisation, all such inactive members will tend to capitalize on the opportunity by surrendering their rights which is otherwise dormant. This implicit buy-back, if allowed at this juncture, will cause major alteration in shareholding strength and cause severe erosion to Exchange corpus. CSEA Ltd,

- after the debacle of March, 2001 is not left with adequate reserve for such consideration.
- c) The source of income of CSEA Ltd. is mainly revenue generated out of listing fee, interest on investments created out of past profits, transaction fees on turnover, annual subscriptions from members, rent received from the members out of space let-out to them in the Exchange premises etc. It is anticipated that the income from listing fee will decrease substantially due to liberal de-listing guidelines of SEBI along-with withdrawal of norms for compulsory listing of companies in Regional Exchanges. Interest on investments is dependant on the quantum of cash available with the Exchange after meeting its current liabilities, and the prevailing interest rates. As the prime lending rate prescribed by the Reserve Bank of India continues to fall as a part of long term fiscal measures, rate of interest and the resulting income generated out of this head will also decrease day by day. Income out of the Transaction fees on turnover is directly related to the volume of business in the Exchange. The trading volume of CSEA Ltd. had reduced drastically after March, 2001 crisis. Availability of diversity in trading platforms like Derivatives, Whole Sale Debt market etc. may encourage substantial increase of business activities. At the present juncture, such facilities cannot be offered to the members due to a number of reasons and therefore, any increase of income in this area is not immediately foreseen. Therefore, it may be imprudent to predict that the Exchange would certainly be able to build up adequate reserves within a specified period of time which may be made available. Hence, any scheme of demutualisation which may require payment of cash to its existing members even after a fixed lock-in period will be impractical considering the viability of the Exchange itself.

3.3. Card System vis-a vis Deposit System

As per Kania Committee recommendation, the Exchange has the option to choose either the card system or the deposit system.

The implications of the said two models is that under card system the existing member/shareholder will get shareholding in the new entity as well as trading rights without any deposit receipt. Under the deposit receipt scheme the members will get a deposit receipt in addition to their trading rights.

3.3.1. Economic implication

Although there may be a lock-in period in respect of refund of deposit, the Exchange remains liable to refund the deposit amount after expiry of lock-in period, which would involve a huge amount of cash outflow from the Exchange to its members. If we look at the latest balance of the Exchange the cash balances sheet available at the disposal of the Exchange does not encourage any such move. Therefore a plan based on the concept of deposit receipt will not be feasible even after a maximum lock-in period of three years as suggested by Kania Committee. The implications of issuance of deposit receipt will be such that the entire amount of cash funds available with the Exchange may not be sufficient for liquidation of the liability after the lock-in period. The survival and the financial solvency of the Exchange will be jeopardised if the Exchange follows the depository system. Therefore it is felt that any model of demutualisation which ultimately results in a threat to the basic existence of the Exchange may not be accepted.

3.3.2. Premium

The market value of the Exchange's card under present market scenario may not attract any premium to the trading rights of the Exchange.

Further, if the per member net-worth is determined by dividing the networth of the Exchange as assessed by the valuers (appointed by the Exchange) by the number of existing members, the formula for calculation of value of deposit receipt as proposed by the Kania Committee may return a negative figure. Thus, the option of issue of deposit receipt is found unsuitable in this case after considering the merits and demerits.

3.3.3. **Planned model**

Therefore, all the existing members of the Exchange will automatically get fully paid-up shares of CSE Ltd. as per the intrinsic value of each of such shares of the Exchange as certified by the Exchange valuer.

All active members of the Exchange who have paid all their dues to the Exchange fully and have contributed to the CSTAR trading system, at the time of demutualisation, will be allotted trading rights. All other members of the Exchange will be eligible for such rights after full payment of all their dues and contribution to CSTAR. The trading rights so acquired can be transferred, subject to approval of board or can be surrendered to the Exchange in future if they desire as such.

Neither cash nor deposit receipts (which may be encashed after its lock-in period) in lieu of shares will be given to the members under this scheme in any case.

3.3.4. **De-coupling of Ownership & Trading Rights**

In the present scheme of demutualisation, the existing members of CSEA Ltd will become shareholders of the CSE Ltd. Subsequently, the existing shareholders may sell/transfer their shareholding in part or full to any other person.

On the other hand, the existing active members of CSEA Ltd will obtain shares as well as trading rights of the CSE Ltd. Such trading rights may be transferred/sold to any other person(s) not having trading rights.

In this process there will be multiple transfers taking place in respect of both shareholding and trading rights depending upon the market condition and willingness of the existing shareholders vis-à-vis the others interested to come to participate in the business at the Stock Exchange. All such transfers between various persons in respect of trading right and ownership right will create multiple class of persons who will be associated with CSE Ltd as follows:-

3.3.5. Shareholders with trading rights

Persons having trading rights and also having shareholding rights in CSE Ltd.

Upon demutualisation, all members who have fully paid all their dues as also contribution to the CSTAR, will belong to this category. Each will automatically obtain trading right and shareholding rights in proportion to their current card holding.

3.3.6. Shareholders without trading rights

Persons having shareholding rights and not having trading rights in CSE Ltd.

Upon demutualisation, all currently inactive members will be in this category. Each will automatically have shareholding rights in proportion to their current card holding but without any trading rights.

3.3.7. With trading rights but without shareholding

Persons having trading rights and not having shareholding rights in CSE Ltd.

This category will be created by transfer of trading rights to non-shareholders by the existing active members after demutualisation. The said transfer will be subject to payment of all outstanding dues of the Exchange, contributions to CSTAR, SEBI turnover fee, other relevant statutory duties and be also subject to such conditions or payments as the Board of Directors of CSE Ltd or SEBI may impose from time to time including transfer fee/charges levied by the Exchange for registration of such transfer. The Exchange may also issue trading membership to encourage new entrants after demutualisation which will also be subject to payment of statutory duties, contribution to CSTAR and other charges levied by the Exchange or SEBI as stated above.

All such contribution to CSTAR System as well as those in para 3.3.3 will form a part of the Settlement Guarantee Fund (SGF) under the provision of compulsory annual contribution of the Exchange towards the Fund.

However, after the expiry of three years from the date on which the segregation of shareholding rights and trading rights will occur, the Exchange will ensure that the shareholding as well as voting right in possession of persons as stated in para 3.3.6 above, is at least 51% of the shareholding/voting powers as on that date and thereafter. In this process the two rights (trading and ownership) will be absolutely de-linked as required by SEBI.

3.4. Exit Route for the members

The proposed scheme of demutualisation of CSEA Ltd provides for two totally de-linked assets in lieu of the present stake of the existing members in the Exchange – (1) fully paid-up shares and (2) trading right of CSE Ltd.

These two rights will be totally de-linked as the trading right in CSE Ltd will not require any minimum shareholding in the new entity. On the other

hand, all existing members would automatically hold shares of CSE Ltd whether he has trading rights or not. Such shares would be transferred at will. Moreover, shareholders of CSE Ltd, who are also trading members, may sell/transfer their trading rights and retain the shareholding only or vice versa. In this process, the CSE Ltd will segregate ownership from trading rights and in turn, existing members will get an exit route in respect of their trading rights.

3.4.1. Exit route relating to Shareholding

It is proposed that after demutualisation, the shares of CSE Ltd will be listed at the Calcutta Stock Exchange and such other Stock Exchanges as the Board may deem fit and these shares will be available for trading in dematerialised form. Therefore, the shares of CSE Ltd will be freely transferable. The present management is of the view that there will be considerable liquidity of the shares of CSE Ltd at the Stock Exchange/s where it will be listed and such shares will command premium in the market in view of future business potential. Therefore any shareholder of CSE Ltd willing to liquidate his holdings (part or full) will be able to do so at the prevailing market price through Secondary Market transaction. The persons who will acquire such shares from the existing shareholders will not get any automatic trading rights of the Exchange. They will only be entitled to get dividend or other corporate benefits as and when the Board of Directors of the company declare the same. They have a right to attend General Meeting of the Exchange and will also enjoy all the rights as available to the shareholders of a company under the Companies Act, 1956.

3.4.2. Exit route relating to Trading rights:

All existing active members who will get trading rights automatically at the time of demutualisation will be required to pay subscription and other charges relating to the services offered by the Exchange from time to time. Such charges may include system related charges, and other charges for service provided in other relevant manner etc.

Presently, the existing active members of CSEA Ltd. will get trading rights and therefore, all of them will be required to pay annual subscription fees and other charges as the Board of CSE Ltd would decide from time to time. All such members will have the following routes to relinquish their trading rights.

3.4.3. Transfer of trading rights

The acquired trading right of CSE Ltd can be sold/transferred to any person who desires to acquire such trading rights of CSE Ltd at a consideration to be mutually decided by the transferor and the transferee at the time of such sell/transfer. The said transfer will be subject to payment of all outstanding dues of the Exchange and SEBI turnover fee, other relevant statutory duties and be also subject to such conditions or payments as the Board of Directors of CSE Ltd or SEBI may impose from time to time including transfer fee/charges levied by the Exchange for registration of such transfer.

3.4.3.1. Surrender of trading rights

The traders who automatically acquire trading rights of CSE Ltd, if not able to find out a buyer for their trading rights and are willing to stop their business due to admissible reasons may surrender their trading rights to the Exchange.

This situation addresses the case of all the active members who are not currently interested to trade on CSEA Ltd but are presently holding their membership card just as an asset may offer to sell their trading rights immediately after the demutualisation. In that case, the sale of trading rights may become a distress sale considering the current market situation. In such cases, the members who are not willing to take the trading rights can surrender the same to the Exchange and afterwards such trading rights will vest in the Exchange and the Exchange would have

the right to sell such trading rights through auction process at such price as the Board of CSE Ltd may decide from time to time. If the Exchange realizes certain sum after auctioning of such trading rights the same will be paid to those members who surrender the same after deducting all the expenses pertaining to auction of the said card and dues in relation to annual subscription/other charges and SEBI turnover fee till such date of auction etc.

3.4.4. Membership relating to deceased members/declared defaulters

In case at the time of demutualisation, transmission of membership of CSEA Ltd is kept in abeyance (where the original member is deceased) due to litigation among the legal heirs/successors, it is proposed that the shareholding as well as trading rights pertaining to all such deceased members will be allotted to a separate entity for the time being, which will be floated as a Special Purpose Vehicle (SPV). This SPV will get shares as well as trading rights in the process of demutualisation equal to the number of deceased members where transmission is in abeyance multiplied by the number of shares allotted to individual members under the scheme of demutualisation.

Subsequently, whenever respective disputes are resolved, proportionate shares along with dividend or other benefits relating thereto as well as trading right of the deceased member will be transferred to such legal heirs as per the respective court order or as per the settlement arrived at between the legal heirs.

Similarly, in all cases where the Exchange has declared a member as defaulter, but the membership of such defaulter has still not been auctioned, either due to litigation or due to absence of buyers, the shareholding as well as trading rights pertaining to all such cards will be transferred to the SPV and will be dealt with in the same manner, as specified above in case of deceased members. If such cards are auctioned

in future by the Exchange, the Exchange will recover all its dues out of such proceeds and pay the residual amount, if any, to such defaulter member.

3.5. Trading Rights

As the Exchange has opted for card system in respect of trading rights rather than deposit receipt system, the trading rights of the Exchange on the date of demutualisation will be confined to the eligible members of CSEA Ltd. After demutualisation, for acquisition of trading rights by any person other than from the existing shareholders or for new admission in CSE Ltd the following ways will be available :-

3.5.1. Transfer of trading rights

The existing active members of CSEA Ltd will be able to transfer their trading rights in favour of desirous person(s) subject to fulfillment of regularity procedure/fee imposed by the Board of Directors of CSE Ltd prescribed from time to time. Such transfer will amount to relinquishment of trading rights by the transferor and the allotment of trading rights to the transferee subject to approval of Board of Directors or any sub-committee as the Board of CSE Ltd may decide from time to time.

3.5.2. Transmission of Membership

In case of death of an existing member the trading rights of the said member will vest with the legal representative/legal heir/successor /authorised nominee of the deceased member subject to such procedure as the board may specify in this regard in compliance with the Indian Succession Act.

3.5.3. **Allotment of new Trading Rights**

In future, if the Board of Directors of CSE Ltd deems fit, it may issue fresh trading rights to any person after going through the selection process/ interview/ experience/ networth/ payment of security deposit etc. in the line with SEBI Stock Brokers & Sub-Brokers Rules depending upon the market conditions prevailing from time to time.

3.6. Widening the shareholders base:

Under the proposed demutualisation scheme the existing shareholders will get shares which will be listed at CSE Ltd and such other Stock Exchanges as the Board of Directors of CSE Ltd may deem fit and will be freely transferable in demat form only. Those shareholders who are not interested to hold their shareholding rights may sell the same in the market. In this process it is proposed that within a period of three years from the date of demutualisation as suggested by Kania Committee the shareholding of brokers holding trading rights in CSE Ltd will come down to below 50% mark. In order to comply with the same the Exchange will stipulate conditions or measures that all the original trading shareholders as a whole who acquired shareholding at the time of demutualisation will liquidate at least 51% of their shareholding within the stipulated period of three years from the date of demutualisation by way of selling/transferring or otherwise, their shares in CSE Ltd to person(s) not having trading right on the CSE Ltd.

In case of failure of such stipulation at the end of three years from the date of allotment of shares of CSE Ltd, the Exchange will analyze the shareholding pattern and ascertain the actual shareholding on that date in possession of persons having trading rights and persons not having trading rights in totality as well as individually. There may be various cases where a broker may transfer his entire shareholding in favour of non- broker,

while some other brokers may not have transferred any share to non-broker.

3.7. Valuation of Assets

3.7.1. Valuation

As per Kania Committee recommendation each and every recognised Exchange has to carry out valuation of assets of the Exchange by a professional valuer before its demutualisation for assessment of intrinsic value of each and every existing/issued shares of the Exchange. On the basis of said recommendation the CSEA Ltd has appointed M/s. L.B.Jha & Co., Chartered Accountants, to carry out an exercise for valuation of each and every issued shares of the Exchange and to submit the valuation report before demutualisation. Such valuation provides a benchmark for actual price of transfer of assets from the existing shareholders of the Exchange to CSE Ltd.

3.7.2. Basis of Valuation

To determine the basis of valuation the Exchange preferred the underlying asset approach (net asset value rather than future income approach) of the Exchange as recommended by Kania Committee due to the fact that future income of the exchange will depend on various extraneous factors which may not be controllable by CSE Ltd. Therefore, the Exchange has decided to opt for the actual net asset value of the assets for each and every issued capital.

3.7.3. Earmarked funds

At the time of the valuation, all the earmarked funds created for specific purposes like Settlement Guarantee Fund (SGF), Customers' Protection Fund (CPA) have not been considered as underlying assets of the CSEA Ltd.

3.7.4. Net worth

The networth of the Exchange has been calculated as Rs.____crores after setting aside the earmarked deposit/funds as stated above. The Exchange currently has 1188 nos. of membership cards. Therefore, the existing members/shareholders of the Exchange will be allotted proportionate shares at the time of demutualisation. After demutualisation all the shares of CSE Ltd will be listed at Calcutta Stock Exchange and such other recognized Stock Exchanges as may be decided by the Board of Directors of CSE Ltd.

4. Governance

4.1. For Profit Company

The CSE Ltd will be a “For Profit Company” which will be owned by the shareholders and be subject to payment of income tax on its profit. It will also change the relationship between the persons trading on CSE Ltd and its Management in view of the fact that the overall management and ownership of the company will be vested with shareholders at least 51% of whom will be outsiders not having trading rights in CSE Ltd.

4.2. Legal issue

To facilitate the process of demutualisation of CSEA Ltd, it is essential to modify the existing Memorandum & Articles of Association in accordance with the existing provisions of the Companies Act, 1956, keeping in view inter-alia, to meet the requirement of minimum/authorized capital, convert it from a non profit making Company to a profit making Corporate body, separation of ownership & trading rights of the existing members, reconstitution of Board of Directors, appointment of CEO etc as per the recommendation of Justice Kania Committee. Rules, Byelaws and Regulations of the Exchange also to be modified in accordance with model rules prescribed by SEBI.

4.3. Management of the Exchange

The overall management of CSE Ltd will be looked after by the Board of Directors to be constituted in the form as stated above. The day-to-day administration including Surveillance & Risk Management, Market operation, Listing, Membership & others will be vested with the Chief Executive Officer to be appointed by the Board. The CEO will have sufficient powers to discharge the responsibility vested on him and he will be responsible for smooth running of the Exchange's function on day-to-day basis. The CEO will have the liberty to appoint any person whether as an officer or staff or others as and when it requires subject to ratification by the Board. The CEO will have all the executive powers in respect of day-to-day administration, would represent the company in all public matters and will be a permanent member of the Board.

As the Board will be formed with equal representation from brokers, shareholders and public representatives, it will function without any influence from any particular forum associated with the Exchange. The Chairman of the Board will always be elected from those other than brokers' representatives. Therefore, the Board of CSE Ltd will be a balanced one without any influence from any particular sector. CSE Ltd will be a profit making company instead of a non-profit making entity. Its profit will be subject to payment of Income Tax and be distributable among its shareholders. This will completely change the present situation of a Limited Company which cannot distribute its profit into a profit making Corporation where, the shareholders can enjoy the same. It will also change the relationship between the brokers of CSE Ltd and its management in view of the fact that the overall management and ownership of CSE Ltd will be vested with shareholders out of which at least 51% will be the outsiders not having any trading rights in CSE Ltd. The conflict between primary regulatory responsibility of capital market and desire to maximise profit for its shareholders will be resolved by having a Board structure of equal representation from brokers, shareholders and

public/investor at large. This will avoid any inclination with respect to decision making/favoring anyone of the three groups having stake in CSE Ltd. As after demutualisation the shares of CSE Ltd will be listed at the Calcutta Stock Exchange and other selected stock exchanges, all norms relating to corporate governance, disclosures of financial results in regular intervals, reporting of various segments, etc. will be applicable to it as it is applicable to any other listed company. The Board will function as an independent authority and shall be vested with powers as stated below, such as :-

- a) It can amend the Memorandum and Articles of Association, Bye-Laws, Rules and Regulations of CSE Ltd as and when it requires and subject to prior approval of SEBI.
- b) Allot fresh trading rights to any person after going through a process of selection as may be stipulated by the Board of CSE Ltd and SEBI from time to time.
- c) Suspend or terminate the service of any employees including those who become employees in future.
- d) It can dispose off or otherwise with any and all of its assets, reserves, properties (including Intellectual Property Rights) interest, license, records, etc. including those acquired by the CSE Ltd in pursuance of the scheme.
- e) It can float any subsidiary company for doing business through other Exchanges for the existing/future members of the Exchange.
- g) The Board have the right to buy back shares of CSE Ltd in accordance with the provisions of Companies Act as and when it decides so.

After demutualisation all obligations and/or liabilities of the CSEA Ltd shall stand vested into and shall become obligations and liabilities of CSE Ltd. The CSE Ltd shall become party to all contract agreements and other instruments in which the CSEA Ltd. was a party before its demutualisation and the same shall be enforced and acted upon by or against CSE Ltd accordingly.

From the date of demutualisation, all the employees of CSEA Ltd shall become the employees of CSE Ltd on the same terms and conditions as existing immediately prior to the date of demutualisation. Seniority of the respective employees and their tenure of service, gratuity and other entitlement based on length of service shall be calculated as if they are continuing with their service with the existing employer.

On and from the date of demutualisation each trading member of CSEA Ltd shall have the automatic trading rights subject to conditions stated earlier and the rules of CSE Ltd and shall be entitled to exercise such trading rights on CSE Ltd as a member.

4.4. Board structure

It is proposed that the reconstituted Board of Directors of CSE Ltd will consist of 10 (Ten) directors as enumerated below:

4.4.1. Broker Directors

3 (Three) Directors to be appointed from Traders as described as “**Stock Broker Representative**” in the definition no. **iv** as stated above subject to election and prior approval from SEBI.

A stock broker representative shall be a person possessing trading rights in the Exchange either as a trading member of CSE Ltd or a partner of a trading member of CSE Ltd and carrying on broking business as a firm or a qualifying director of a trading member of CSE Ltd which is a company or a

nominee of a corporate trading member duly authorised by the board of the said corporate member. The persons as stated aforesaid may or may not have a share capital of CSE Ltd. The stock brokers' representative will be elected by the shareholders in each and every Annual General Meeting and shall be approved by SEBI before holding office as a director in CSE Ltd. 1/3rd of each and every stock brokers' representative will be subject to retirement by rotation at each AGM.

4.4.2. **Shareholders Directors**

3 (Three) Directors to be appointed from Shareholders as described as "**Shareholder Representative**" in the definition no. **v** as stated above subject to election and prior approval from SEBI.

A shareholders' representative shall be a person possessing at least one share of the CSE Ltd and at the time of appointment as a Board member or thereafter he shall not be a stock broker or sub-broker of CSE Ltd or any other recognised Exchange of India or he is not interested or associated with a firm or a corporate entity carrying business of shares, stocks, etc. in the capacity of shareholder, director, employee or close relatives of any trading member of CSE Ltd whatsoever in any other capacity including as a constituents. The shareholders' representative will be elected by the shareholders in each and every Annual General Meeting and shall be approved by SEBI before holding office as a director in CSE Ltd. 1/3rd of each and every shareholders' representative will be subject to retirement by rotation at each AGM.

4.4.3. **Public Directors**

3 (Three) Directors to be appointed from Public / Investor as described as "Public Representative / Investor Representative" in the definition no. **vi** as stated above subject to approval from SEBI

A Public Representative/Investor Representative shall be a person as may be selected by the board of directors of CSE Ltd from amongst

academicians, professionals, industry representative, renowned public figures, nominee of investors association/societies subject to prior approval of the SEBI. The person so appointed shall not be at the time of his appointment or thereafter be a stock broker or a sub-broker or interested/ related/ associated with a firm of a corporate entity carrying on business of shares and securities in a capacity of shareholders/directors or employees or any other capacity whatsoever including constituent. He shall not be engaged in business of dealing in securities and prior to his appointment as a director he has to file a written undertaking with CSE Ltd that if appointed as a director or during his tenure as a public representative/ investor representative, he will not undertake any business as a stock broker/sub-broker or otherwise.

4.4.4. **The CEO of the Exchange**

The CEO shall be a person having in depth knowledge & experience of day to day functioning of a recognised Stock exchange in India or any other stock exchanges in the world and / or working experience in intermediaries of Capital market. At the time of his appointment and thereafter during his tenure as CEO, he shall not be a “Stock Broker”, “Sub Broker”, interested / associated directly or indirectly in a Partnership firm or Corporate Body carrying on Security business as a shareholder, director, employee or in any other capacity whatsoever. The appointment of CEO will be approved by the Board of Directors of CSE Ltd, subject to ratification by SEBI

4.4.5. **Voting Rights**

The voting rights available to the shareholders of the CSE Ltd will be in proportion to the number of shares held by each of them on the book closer/record date.

It is proposed to impose a ceiling of 5% in respect of voting rights by a single entity or entities related with each other or groups irrespective of size of ownership of the shares. It will be compulsory on the part of the

shareholders of CSE Ltd to declare to the management of Exchange as soon as their shareholding reaches more than 4% of the total paid-up capital of CSE Ltd. If the management of CSE Ltd find that any transfer of shares to any entity or otherwise will result into concentration of shareholding /voting rights of more than 5% in the hands of any individual or a group of persons having nexus with each other, the management of CSE Ltd will have the power to withdraw the shareholding rights/voting power of such shareholders in excess of 5% shareholding. The voting rights of each and every broker made available to them upto such time the SEBI will allow them to exercise the same.

In order to prevent any concentration of voting powers the following provisions will be implemented in CSE Ltd.

No person in India or outside India shall in any manner whatsoever directly or indirectly acquire or hold or exercise whether by himself or with concert with any other person(s) can enjoy in excess of 5% of total voting rights of the members of CSE Ltd.

SEBI and the management of the CSE Ltd may grant an exemption to that 5% limit subject to such conditions as the management of the CSE Ltd may deem fit from time to time for investment by banks, financial institutions, other stock exchanges or a company of repute pursuant to a scheme of merger/acquisition/holding company etc.

If any person contravenes the provision of maximum 5% of total holding the management of the CSE Ltd may take necessary action subject to approval or concurrence of SEBI to ensure that the person(s) ceases to hold or exercise voting rights in excess of 5% by an appropriate order. The management of CSE Ltd may direct such person(s) to dispose off their respective shareholding so that the voting rights of the said persons/groups will be reduced to 5%. Otherwise, the management can attach the membership or voting rights or refrain such person(s) from

trading in the Exchange or may issue any other orders as it deem fit, until and unless such person(s)/group complies with the order of the management of CSE Ltd. Any act contrary to the order passed by the management of CSE Ltd/SEBI shall be considered void.

4.5. Listing of CSE Ltd

As it is proposed that after demutualisation, the shares of CSE Ltd will be listed at Calcutta Stock Exchange and such other Stock Exchanges as the Board may deem fit and these shares will be available for trading in demat form only. Therefore, the shares of CSE Ltd will be freely transferable.

4.6. Buy Back of Shares by CSE Ltd

No buy back of shares of CSE Ltd is planned at this juncture.

4.7. Impact on registration of stock brokers and SEBI turnover Fee

Any change in the name, status, organisation and management set up on and from the date of demutualisation of CSE Ltd pursuant to the scheme of demutualisation to be subsequently ratified by the SEBI with or without modification, will have no impact on the status of members/traders in respect of their liability relating to SEBI turnover fees. Therefore, all the brokers can continue their trading activities with the same SEBI Registration Number as they hold in CSEA Ltd to the CSE Ltd. The continuity benefit and the chargeability and quantum of SEBI fee payable by the Stock Broker on the basis of inception of their respective broking activity will remain the same irrespective of change of organisation structure of CSEA Ltd into CSE Ltd on the basis of this scheme of demutualisation.

5. Statutory issues

5.1. Tax implications for the Exchange and the Members:

The Hon'ble Finance Minister, in his Budget speech, announced certain relief to the recognised stock exchanges if they demutualise according to a scheme duly approved by SEBI. Any transfer of assets by the existing exchange to the new demutualised exchange at the time of demutualisation will not attract any tax liability either in the hands of transferor or the transferee.

5.1.1. In respect of past assessment of the Exchange

At present the management of CSEA Ltd is contesting various litigation in respect of tax exemptions availed by it in earlier assessments. The Income Tax Department has challenged the charitable status of the Exchange and has imposed tax on surplus in the hands of the Exchange. Also, the said department is now planning to consider the development fee received from the members at the time of fresh allotment of shares to financial institutions or any other persons by the Exchange as revenue receipt instead of capital receipt and to charge tax accordingly on such development fees. The Exchange authority also challenged the department's tax treatment in various levels (CIT [Appeal]/Tribunals, etc.).

In the process of demutualisation, the Exchange would be converted from a non-profit making company to a profit making company. After demutualisation the Exchange will be in a position to distribute surplus profit to its shareholders. Therefore, in order to avoid any complication in the said matter including the liability of the past assessment which may have to borne by CSE Ltd after end of prolonged litigation, it would be prudent to request CBDT or Ministry of Finance to issue appropriate notifications so that there will be no tax implication on the Exchange in respect of the past assessments arising out of the change of status of the company.

5.1.2. In the hands of existing members at the time of demutualisation

As per announcement of the government, assets if any acquired by the members of a recognised stock exchange in connection with the scheme of demutualisation duly approved by SEBI will not attract any tax both in the hands of transferor/transferee. Therefore, there will be no tax payable by the members for getting allotment of shares in CSE Ltd as well as continuation of trading rights irrespective of the value of shares allotted to them at the time of demutualisation vis-v-vis their original cost of acquisition of membership. It is proposed that the actual process of allotment of shares to members will be initiated by the management of CSE Ltd, only after getting approval of the said scheme by SEBI and all such allotment will be strictly as per the Scheme.

5.1.3. In the hands of shareholders of CSE Ltd on subsequent transfer

As per the budget announcement the cost of acquisition in respect of shares/trading rights acquired by the existing members of a recognised stock exchange under the process of demutualisation will be considered as nil. Therefore at the time of subsequent sell/transfer of any of these assets either in part or full and the consideration received thereof by the members will be subject to income tax and would also not attract indexation benefit as the acquisition cost will be considered to be nil. In order to reduce tax liability in the hands of members, it is proposed to complete the process of demutualisation including fresh allotment of shares by the Management of CSE Ltd to the members within financial year 2003-04 so as to avail the benefit relating to capital gains as notified by the Hon'ble Finance Minister in the Budget proposal placed before the Parliament in February 2003. In the said proposal it is reiterated that any person getting allotment of shares during the financial year 2003-04 and hold the same for at least a period of one year from the date of its allotment and if the said persons subsequently sell/transfer such shares they will be exempted for capital gains. Therefore, if the existing members are allotted fresh shares at the time of

demutualisation by CSE Ltd during the financial year 2003-04 and subsequently the same is disposed off by the members after holding the same for at least one year, there will be no tax in the hands of the members. But money receipt of any member on sale/transfer of trading rights after the demutualisation will be considered as income in the hands of transferor and would be subject to payment of income tax.

6. Conclusion

If any difficulty arises in giving effect to the provisions of the Scheme the Board may modify the relevant clauses of the Scheme or make such provision and issue such clarification as it may deem fit for removing the difficulties at the time of its implementation with due approval from SEBI.

The Exchange hereby submits this scheme of demutualisation before SEBI for its approval.

Annexure : Executive Summary

SEBI had advised all Stock Exchanges to formulate Scheme for Corporatisation and Demutualisation on the basis of recommendations of Justice Kania Committee and submit the same to SEBI within 31st July 2003 for its approval and subsequent implementation. The Calcutta Stock Exchange Association Limited (CSEA Ltd) is a Company limited by shares, and therefore is already corporatised. It has now finalised a “Scheme for Demutualisation” involving de-coupling of trading & ownership rights and re-constituting the Management Structure of The Calcutta Stock Exchange Limited (CSE Ltd).

In most of the cases of demutualisation internationally, no cash considerations were paid to the members in lieu of their ownership in the old entity. Almost in all cases, the old members were allotted shares on surrender of their existing rights in the exchange. Further, any proposal of demutualisation, which directly or indirectly involves funds outflow, or distribution of money out of corpus of CSEA Ltd will be detrimental to the interests of the Exchange as it will seriously deplete Exchange resources and jeopardize its very existence under the present poor financial condition irrespective of any lock-in period.

Card System vs Deposit System

As per Kania' Committee recommendation, the Exchange has the option to choose either card system or deposit system. Under card system the existing member/shareholder will get shareholding in the new entity as well as trading rights without any deposit receipt. Under the deposit receipt scheme the members will get a deposit receipt in addition to their trading rights. Although there may be a lock-in period in respect of refund of deposit, the Exchange remains liable to refund the deposit amount after expiry of lock-in period. The present financial position of the Exchange

does not encourage any such move. Therefore a plan based on the concept of deposit receipt will not be feasible even after a maximum lock-in period of three years. Thus, we propose to take the option of card system.

All active members of the Exchange who have paid all their dues to the Exchange fully at the time of demutualisation, will be allotted trading rights. All other members of the Exchange will be eligible for such rights after full payment of all their dues. The trading rights so acquired can be transferred subject to approval of the Board or can be surrendered to the Exchange in future if they desired as such. Trading right in CSE Ltd will not require any minimum shareholding. In future, if the Board of Directors of CSE Ltd deems fit, it may issue fresh trading right to any person after going through the selection process in line with SEBI Stock Brokers & Sub-Brokers Rules depending upon the market conditions prevailing from time to time.

Three Groups

After demutualisation, the following Groups will be associated with CSE Ltd: (i) Shareholders with trading rights, (ii) Shareholders without trading rights & (iii) With trading rights but without shareholding. Within three years from the effective date of demutualisation, it will be ensured that the shareholding/voting right in possession of persons as in Group (ii) above is more than 50% of shareholding /voting powers.

Exit Routes

After demutualisation, the shares of CSE Ltd will be listed at the Calcutta Stock Exchange and such other Stock Exchanges as the Board may deem fit and these shares will be available for trading in dematerialised form only. Therefore any shareholder of CSE Ltd willing to liquidate his holdings (part or full) will be able to do so at the prevailing market price through Secondary Market transaction. The persons who will acquire such shares will not get any automatic trading rights of the Exchange. They will enjoy

all the rights as available to the shareholders of a company under the Companies Act.

The acquired trading right of CSE Ltd can be sold/transferred to any person who desires to acquire such trading rights of CSE Ltd at a consideration to be mutually decided by the transferor and the transferee at the time of such sale/transfer. The said transfer will be subject to payment of all outstanding dues of the Exchange, SEBI turnover fee and other relevant statutory duties and be also subject to such conditions or payments as the Board of Directors of CSE Ltd or SEBI may impose from time to time including transfer fee/charges levied by the Exchange for registration of such transfer.

Any Group-(i) member may surrender his trading rights to the Exchange which will vest in the Exchange and the Exchange would have the right to sell such trading rights through auction process at such price as the Board of CSE Ltd may decide from time to time. If the Exchange realizes certain sum after auctioning of such trading rights the same may be paid to those members after deducting all the expenses pertaining to auction of the said card and realization of all other dues.

Disputed/ Deceased Members

The shareholding as well as trading rights pertaining to all disputed and/or deceased members will be allotted to a separate entity for the time being, which will be floated as a Special Purpose Vehicle (SPV). This SPV will get shares as well as trading rights in the process of demutualisation. Subsequently, whenever respective disputes are resolved, proportionate shares along with dividend or other benefits relating thereto as well as trading right of the disputed / deceased member will be transferred to such legal heirs as per the respective court order or as per the settlement arrived at between the legal heirs / disputed parties.

Valuation of Assets

CSEA Ltd has appointed M/s L.B. Jha & Co., Chartered Accountants, to carry out an exercise for evaluation of the net worth of Exchange assets, which has been calculated as Rs.____crores after setting aside the earmarked deposit/funds like SGF, CPF etc. Therefore, each of the existing shareholders of the Exchange will be allotted shares equivalent to the total networth of the Exchange at the time of its demutualisation divided by the number of shareholders.

CSE Ltd will be a “For Profit Company” which will be owned by the shareholders and be subject to payment of income tax on its profit. After demutualisation all obligations and/or liabilities of the CSEA Ltd shall stand vested into and shall become obligations and liabilities of CSE Ltd.

To facilitate the process of demutualisation of CSEA Ltd, it is essential to modify the existing Memorandum & Articles of Association in accordance with the existing provisions of the Companies Act, 1956, to convert it from a non profit making Company to a profit making Corporate body, separation of ownership & trading rights of the existing members, reconstitution of Board of Directors, appointment of CEO etc. Rules, Byelaws and Regulations of the exchange also to be modified in accordance with model rules prescribed by SEBI.

From the date of demutualisation, all the employees of CSEA Ltd shall become the employees of CSE Ltd on the same terms and conditions as existing immediately prior to the date of demutualisation. Seniority of the respective employees and their tenure of service, gratuity and other entitlement based on length of service shall be calculated as if they are continuing their service with the existing employer.

Management Structure

The overall management of CSE Ltd. will be looked after by the Board of Directors. The day-to-day administration including Surveillance & Risk Management, Market operation, Listing, Membership & others will be

vested with the Chief Executive Officer to be appointed by the Board. The CEO will have sufficient powers to discharge the responsibility vested on him.

The Board will be formed with equal representation from brokers, shareholders and public representatives and will function without any influence from any particular class of stakeholders associated with the Exchange. The Chairman of the Board will always be elected from those other than brokers' representatives.

It is proposed that the reconstituted Board of Directors of CSE Ltd will consist of 10 (Ten) directors as shown below. All appointments are subject to prior approval from SEBI.

3 Directors to be appointed as "Stock Broker Representative" who may or may not be a shareholder, subject to election by the shareholders and 1/3rd of them will retire by rotation at each AGM.

3 Directors to be appointed as "Shareholder Representative" who will not be traders, subject to election by the shareholders and 1/3 rd of them will retire by rotation at each AGM.

3 Directors to be appointed from Public / Investor as "Public Representative / Investor Representative" who will be neither shareholders nor traders.

The CEO of the Exchange, who will be a permanent member.

Ceiling on Voting Rights

It is proposed to impose a ceiling of 5% in respect of voting rights by a single entity or entities related with each other or groups irrespective of size of ownership of the shares.

The scheme of demutualisation will have no impact on the status of members/traders in respect of their liability relating to SEBI turnover fees.

Tax Implications

At the time of demutualisation any transfer of assets by the existing Exchange to the new demutualised Exchange will not attract any tax liability either in the hands of transferor or the transferee.

It is presumed that there will be no tax payable by the members for getting allotment of shares in CSE Ltd as well as continuation of trading rights irrespective of the value of shares allotted to them at the time of demutualisation vis-a-vis their original cost of acquisition of membership.

If the existing members are allotted fresh shares at the time of demutualisation by CSE Ltd during the financial year 2003-04 and subsequently the same is disposed off by the members after holding the same for at least one year, there will be no tax liability for the members. Therefore, in order to reduce tax liability, it is proposed to complete the process of demutualisation including fresh allotment of shares within financial year 2003-04.

However, money receipt of any member on sell/transfer of trading rights after the demutualisation will be considered as income in the hands of transferor and should be subject to payment of income tax.

If any difficulty arises in giving effect to the provisions of the Scheme the Board may modify the relevant clauses of the Scheme or make such provision and issue such clarification as it may deem fit for removing the difficulties at the time of its implementation with due approval from SEBI.