

## PART ONE: POLICIES AND PROGRAMMES

This Annual Report of the Securities and Exchange Board of India (SEBI) presents a review of its policies and programmes, its working and operations in the financial year, 2002-03. The Report also describes the manner in which the SEBI has been discharging its functions and exercising powers in terms of the Securities and Exchange Board of India Act, 1992; the Securities Contracts (Regulation) Act, 1956; the Depositories Act, 1996; as well as in terms of the delegated powers under the Companies Act, 1956. The Report also provides details of the developments in Indian securities market during 2002-03 and their bearing on and relation with the work of the SEBI. The Report has been prepared in accordance with the format prescribed in the Securities and Exchange Board of India (Annual Report) Rules, 1994, notified in the Official Gazette on April 7, 1994.

The SEBI operates within the legal framework of the SEBI Act, 1992. The statutory objectives of the SEBI as enshrined in the SEBI Act, 1992 are fourfold:

- Protection of the interests of investors in securities
- Development of the securities market
- Regulation of the securities market, and
- Matters connected therewith and incidental thereto.

In keeping with these statutory objectives, the SEBI has set for itself strategic aims in the four key spheres which encompass SEBI's

activities, viz, the investors, issuers, intermediaries and the regulatory regime. To the investors, the SEBI strives to assure that their rights are protected, they are able to make informed choices and decisions and the market is fair in the financial dealings.

To the issuers, the SEBI strives to provide a transparent, efficient market where they are able to raise resources at reasonable cost, and conduct themselves in accordance with the highest standards of corporate governance and that they are conscious of and meet their regulatory obligations.

To the intermediaries, the SEBI strives to provide a market in which they can compete freely and operate in a manner which gives the investors and market participants confidence that the market is efficient, orderly and fair. In the regulatory regime, the SEBI seeks to ensure that it always remains appropriate, proportionate and effective in which all "stakeholders" have the confidence.

With these strategic aims in view, the SEBI has been constantly reviewing and reapprising its policies and programmes, formulating new policies and regulations to cover areas hitherto unregulated or inadequately regulated and to implement them in a manner to promote the growth of the market with transparency, fairness, efficiency and integrity.

The major policy reforms and developments in the Indian securities market during 2002-03 are presented in Box 1.1.

### **Box 1.1: Major Policy Reforms and Developments in the Securities Markets during 2002-03:**

During 2002-03, SEBI initiated several structural changes in the securities market and worked assiduously to achieve them. Some of the major accomplishments of SEBI during the last financial year are as follows :

- Implementation of T+3 rolling settlement for all listed securities across the exchanges from April 2, 2002 to move T+2 on April 1, 2003.
- Introduction of scientific model for risk management, based on VaR.
- Introduction of Electronic Data Information Filing And Retrieval (EDIFAR) System to facilitate electronic filing of certain documents/statements by the listed companies and their immediate disclosure to the market participants.
- Launch of Securities Market Awareness Campaign.
- Introduction of rating corporate governance on the principles of wealth creation, wealth management and wealth sharing.
- Introduction of Straight Through Processing (STP) for the securities transaction.
- Implementation of a comprehensive risk management system for Mutual Funds.
- Introduction of the Dual fungibility of ADRs and GDRs.
- Establishment of the Central Listing Authority (CLA).
- Issuance of necessary guidelines/circulars for Corporatization and Demutualization of stock exchanges.
- Introduction of the trading of Government Securities on the Stock Exchanges.
- Posting all the orders passed by the Securities Appellate Tribunal (SAT) and the Board on the SEBI website, to bring in regulatory transparency.
- Introducing the consultative process on policy formulation by putting all reports of committees and draft regulations on the SEBI website for seeking comments, suggestions and opinions from public.
- Issuance of guidelines on Delisting of Securities from the Stock Exchanges.
- Establishment of inter-depository transfer through on-line connectivity between CDSL and NSDL.
- Review and amendment of the following regulations and guidelines – a measure of regulatory proactiveness
  - ✓ SEBI (Insider Trading) Regulations, 1992
  - ✓ SEBI (Underwriters) Regulations 1993
  - ✓ SEBI (Debenture Trustees) Regulations, 1993
  - ✓ SEBI (Portfolio Managers) Regulations, 1993
  - ✓ SEBI (Foreign Institutional Investors) Regulations 1995
  - ✓ SEBI (Mutual Fund) Regulations, 1996
  - ✓ SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 1997
  - ✓ SEBI (Employee Stock Option Scheme & Employee Stock Purchase Scheme) Guidelines, 1999.
  - ✓ SEBI (Credit Rating Agencies) Regulations, 1999
  - ✓ SEBI (Issue of Sweat Equity) Regulations, 2002
  - ✓ SEBI(Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations 2002.
- Announcement of Accounting Standards and disclosure practices of the Indian companies by ICAI in consultation with SEBI in accordance with International Accounting Standards.
- Expansion of the derivatives products basket.
- Introduction of benchmarking of all the Mutual Funds Schemes to facilitate the understanding of the investors about the performance of the funds.
- Introduction of nomination facility for the unit holders of mutual funds.
- Simplification of documentation procedure for FII registration and reduction of registration fee for FIIs.
- Memoranda of Understanding (MoUs) for co-operation and information sharing were signed with international regulators like Securities and Finance Commission of Mauritius and Securities and Exchange Commission of Sri Lanka.

## 1. REVIEW OF THE GENERAL ECONOMIC ENVIRONMENT AND THE INVESTMENT CLIMATE

### I. General Economic Environment

The growth rate in Gross Domestic Product (GDP) of India has been experiencing a checkered history in the recent past. Provisional estimates of Central Statistical Organization for the year 2002-03 show an expected GDP growth rate of 4.4 per cent. Compared to the immediate previous year it is lower by 1.6 percentage points. A fall of 27 per cent. The agriculture sector – pulled deceleration in growth, in 2002-03 clouding across-the-board improvement in the growth performance of industry and services. Actually, industry and services sectors recorded growth from 3.3 percent to 6.1 percent and 6.8 percent to 7.1 percent respectively, between 2001-02 and 2002-03.

#### Gross Domestic Savings

Gross Domestic Savings (GDS) have been hovering around an average 23 percent for the past 4 years. The details of GDS and its

components are presented in Table 1.1 and Chart 1.1. A notable feature of savings is that household savings have been increasing for the past 5 years starting from 1997 -98 till 2001-02; it grew from 17.6 percent to 22.5 percent of GDP. Public sector savings have been coming down gradually from 1995-96 till 2001-02 and the pace of decline accelerated in 2000-01. Public sector savings showed negative savings for the past four years. The ratio of financial assets to physical assets has been increasing. Savings in financial assets have been rising for the past four years albeit slowly. More than 50 percent of the household savings have been in financial assets. The portion of shares and debentures have come down drastically, it was 0.9 percent of GDP in 1999-00 and fell to 0.3 percent of GDP in 2001-02 recording a two-thirds decline. Investments in contractual savings is more or less stable over the past four years. Details of savings and investments, household savings in financial assets and other macro economic indicators are presented in Tables 1.1 to 1.3 and Charts 1.1 to 1.3

**Table 1.1: Savings and Investment Trends in Indian Economy**

	1998-99	1999-2000	2000-01 (P)	2001-02 #
<b>As percent of GDP at Current Market Prices</b>				
<b>Gross Domestic Savings</b>	<b>21.5</b>	<b>24.1</b>	<b>23.4</b>	<b>24.0</b>
Public	-1.0	-1.0	- 2.3	- 2.5
Private	3.7	4.4	4.1	4.0
<b>Households Savings</b>	<b>18.8</b>	<b>20.8</b>	<b>21.6</b>	<b>22.5</b>
Financial Assets	10.5	10.8	11.0	NA
Physical Assets	8.4	9.6	9.9	NA
Private Corporate Saving	3.7	3.7	4.2	NA
<b>Gross Domestic Investment</b>	<b>22.6</b>	<b>25.2</b>	<b>24.0</b>	<b>23.7</b>
Public	6.5	6.2	6.1	5.9
Private	15.1	15.6	15.8	15.7
<b>GFCF</b>	<b>21.5</b>	<b>21.8</b>	<b>21.8</b>	<b>21.7</b>

GFCF: Gross Fixed Capital Formation

P: Provisional estimates. NA: Not Available # Preliminary

Source: Economic Survey, Government of India 2002-03, RBI Annual Report 2001-02.

Chart : 1.1 Gross Domestic Saving and Gross Domestic Investment  
(as percentage of GDP)

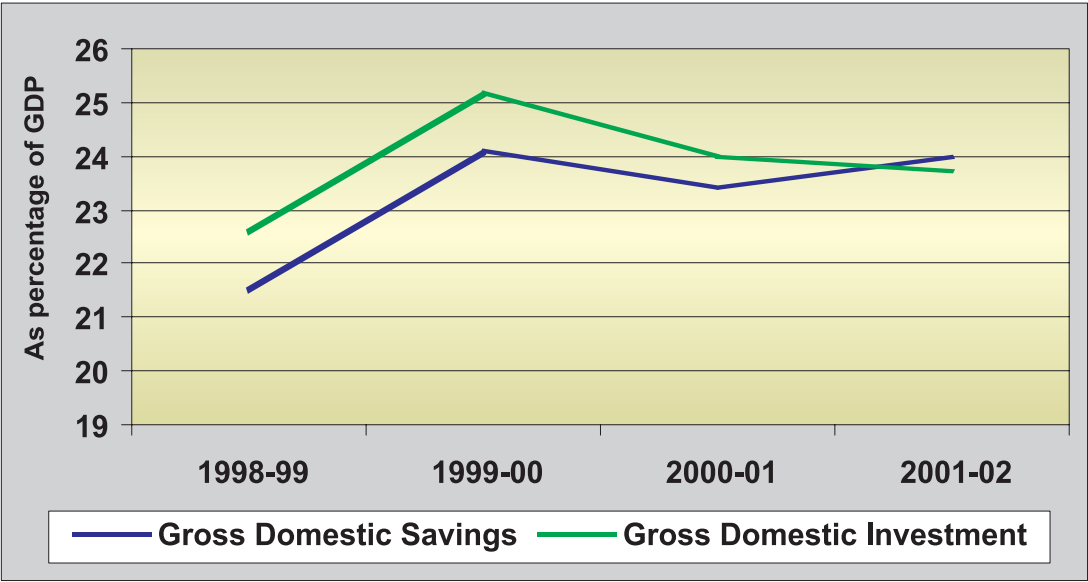


Table 1.2: Savings of the Household Sector in Financial Assets

(Rs crore)

Item	1998-99	1999-00	2000-01	2001-02 #
Financial Assets	2,07,390 (11.9)	2,39,058 (12.4)	2,56,734 (12.3)	2,91,405 (12.7)
Currency	21,822 (1.3)	20,845 (1.1)	17,686 (0.8)	28,192 (1.2)
Deposits	80,250 (4.6)	89,598 (4.6)	1,05,078 (5.0)	1,12,517 (4.9)
Claims on Government	28,220 (1.6)	28,985 (1.5)	39,008 (1.9)	49,923 (2 B.2)
Shares and Debentures +	6,992 (0.4)	17,045 (0.9)	6,135 (0.3)	6,946 (0.3)
Contractual savings *	69,836 (4.0)	82,585 (4.3)	88,828 (4.3)	93,827 (4.1)
Financial Liabilities	26,773 (1.5)	35,275 (1.8)	32,229 (1.5)	40,451 (1.8)
Savings in financial Assets	1,80,617 (10.4)	2,03,783 (10.6)	2,24,505 (10.8)	2,50,954 (10.9)

# Preliminary

+ Includes Units of UTI and other Mutual Funds

\* Comprise Life Insurance, Provident and Pension Funds.

Figures in parentheses are percent of GDP at current market prices.

Source: RBI Annual Report 2001-02.

Chart 1.2 : Components of Household Savings (as percentage of GDP)

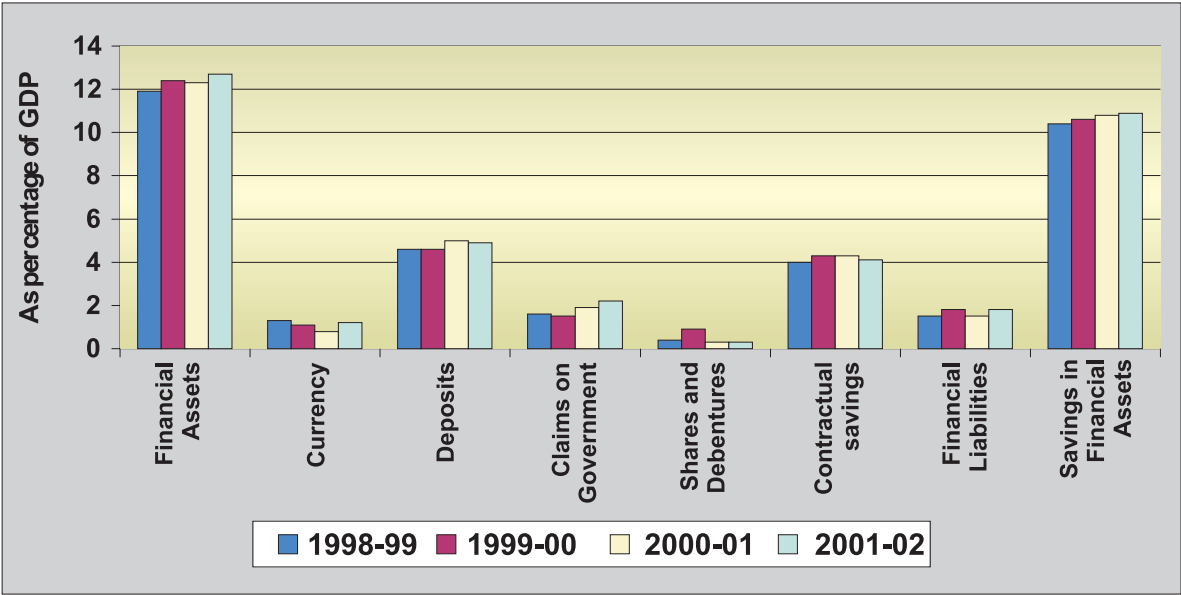
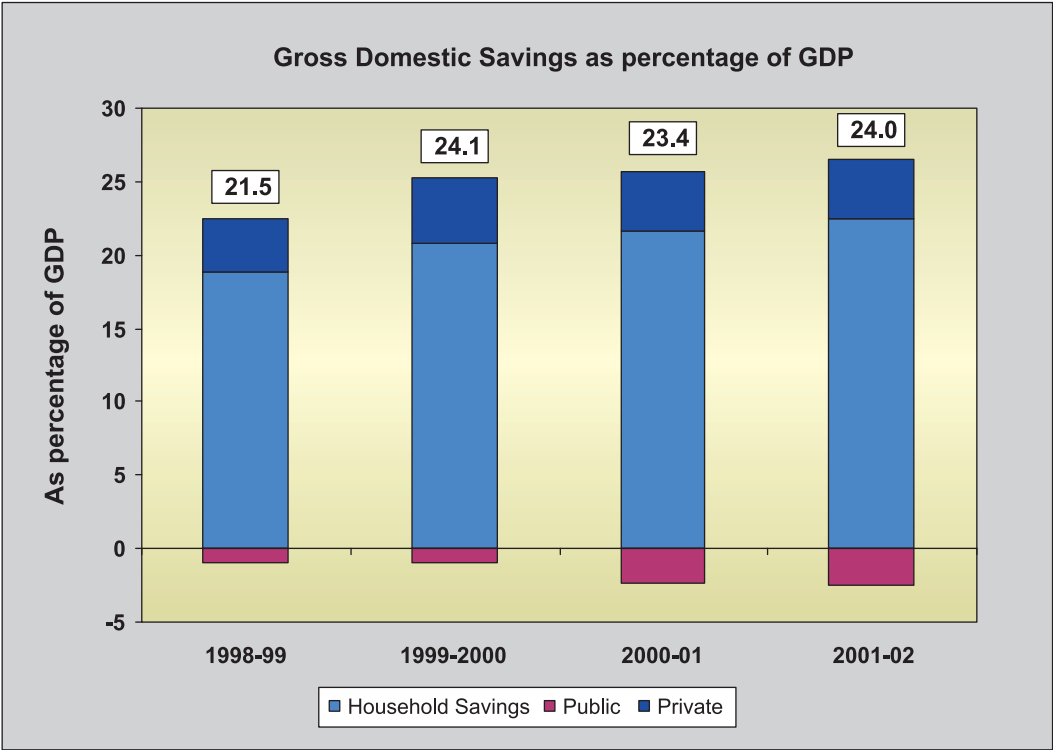


Chart 1.3 : Share of Savings Types in GDP



Foreign exchange reserves of India have been growing at a faster rate over the past few years. With growth rates of 11.1 percent, 28.2 percent and 38.1 percent during 2000-01, 2001-02 and 2002-03 respectively, the total reserves at the end of 2002-03 stood at US\$ 74.805 billion. This is a record achievement. Average inflation (provisional) for the year 2002-03 is 3.0 percent, higher than what it was in 2001-02. The growth rate of money supply (M3) has been more or less constant providing further strength to stable price levels and interest rates. A close look at these macro economic indicators reveals stable and positive developments. Thus the economy of the country looks strong and is marching ahead. This should auger well for the capital market also.

Facilitated by relatively lower inflation, interest rates continued to soften during the year. The RBI reduced the bank rate by 25 basis point to 6.25 percent in October 2002. At the present level, the bank rate is the lowest since 1973. The yield on 7.4 percent 12 year government paper reached a low of 6.13 percent on December 31, 2002.

In 2002-03 fewer number of issuers accessed capital market through the primary market route to mobilise resources compared to 2001-02. In 2002-03, a total of Rs. 4070 crore

was mobilized as against Rs. 7543 crore in 2001-02. Both public and rights issue market exhibited subdued trend in 2002-03. Banks and financial institutions were the main fund mobilisers during the year.

Performance of secondary market also did not show any encouraging trend. In fact popular indices such as S&P CNX Nifty and Sensex and other broad indices such as BSE National Index and S&P CNX 500 also recorded losses ranging from 8 percent to 13.4 percent. Nifty lost the maximum while BSE 500 lost the least at 13.4 percent and 8 percent, respectively. But considering the P/E and price to book ratio, Indian market continued to be more attractive (cheaper). The total turnover of all the exchanges in 2002-03 grew up by 8 percent at Rs. 9,69,164 crore compared to Rs. 8,95,817 crore in 2001-02. Turnover at NSE was the largest (20 percent growth) while BSE recorded an increase of 2.2 percent.

Mutual funds mobilized, on gross basis, a record Rs. 3,14,706 crore in 2002-03 but repurchases also rose substantially to Rs. 3,10,509 crore recording a net inflow of only Rs.4196 crore.

The year 2002-03, thus, witnessed a mixed record of performance. Some sectors, like the

Table 1.3: Macro Economic Indicators

Parameters	2000-01	2001-02	2002-03
Money Stock (M3) *	1311583	1500003	1727877
(Rs. Crore)	(16.4)	(14.1)	(15.3)
Foreign Exchange Reserves *	42.256	54.154	74.805
(US \$ Bn.)	(11.1)	(28.2)	(38.1)
		11.9	20.7
Wholesale Price Index *	160.7	164.7	171.6
(Base Year 1993-94 = 100)	(5.2)	(2.5)	(4.2)
Gross Domestic Product	1917724	2094013	2217800
(Rs. Crore) (current prices)	(8.8)	(9.2)	(6.6)
Gross Domestic Product (1993-94 prices )	1186300	1257000	1309900
(Rs. Crore)	(4.3)	(6.0)	(4.4)

Figures in the parentheses indicate percentage change over the previous year.

\* Last day of the respective year.

Source: Reserve Bank of India and Central Statistical Organisation

mutual funds, performed better than the previous year while others including resources mobilised in primary issues and performance of secondary market continued to be subdued.

## **2. REVIEW OF POLICIES AND PROGRAMMES**

During 2002-03, SEBI took several new initiatives and revised some of its existing policies and programmes. These measures have been listed at the beginning of the annual report. In the following sections these are discussed in greater detail.

### **I. Primary Securities Market**

The objectives of reviewing the existing policies and for initiating new policies in Primary Market Department, are as follows :

- A. To help the investors make more informed investment decision.
- B. To make regulations more transparent, effective and understandable to the regulated entities.
- C. To give confidence to the investors and other participants that the markets are efficient, orderly and clean.
- D. To increase the transparency, efficiency of the primary market so as to sustain the confidence of investors and market participants.

To achieve the above objectives, the following steps were taken:

- A. The disclosure requirements in offer documents for Public Issue/Rights Issue/ Offer for Sale, were streamlined and strengthened.
- B. The existing procedure and process of registration and renewal of registration were reviewed and streamlined.

- C. The existing regulations pertaining to intermediaries / other existing guidelines/ regulations, were reviewed and amended where necessary.

Accordingly following regulations were amended /reviewed:

- a. SEBI (Merchant Bankers) Rules and Regulations, 1992
- b. SEBI (Debenture Trustees) Rules and Regulations, 1993
- c. SEBI (Portfolio Managers) Rules and Regulations, 1993
- d. SEBI (Registrars to an Issue and Share Transfer Agents) Rules and Regulations, 1993
- e. SEBI (Underwriters) Rules and Regulations, 1993
- f. SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999
- g. SEBI (Issue of Sweat Equity) Regulations, 2002

### **II. Secondary Securities Market**

#### **A. Shortening of settlement cycle from T+5 to T+3 to T+2**

Rolling settlement on T+5 basis, which was made compulsory in all stock exchanges for 200 actively traded scrips in BSE and NSE, was extended to cover all scrips from December 31,2001. The settlement cycle was then shortened to T+3 from April 01, 2002. The transition from T+5 to T+3 took place smoothly without any glitches. In order to derive greater benefits of increased efficiency of the rolling settlement and ensure speedier settlement, the need for contracting the rolling settlement cycle from existing T+3 to T+2 was felt. Market participants were intimated about



further shortening of the settlement cycle to T+2 from April 1, 2003.

### ***B. Demutualisation and Corporatisation of the Stock Exchanges***

Following the announcement by the Hon'ble Finance Minister in the Parliament on March 13, 2001 that "corporatisation of stock exchanges by which ownership, management and trading membership would be segregated from each other, SEBI constituted a 'Committee on Corporatisation and Demutualisation of Stock Exchanges' under the Chairmanship of Justice M H Kania, former Chief Justice of India, for advising SEBI on corporatisation and demutualisation of exchanges and to recommend the steps that need to be taken to implement the same. Recommendations of the committee were accepted with the exception that in the case of NSE, the present structure of its board would be maintained and the voting rights of the shares held by the broker members would be determined by SEBI in consultation with the Government of India.

SEBI issued circulars to all stock exchanges advising them the scheme for uniform model of corporatisation and demutualisation. The stock exchanges are required to submit their proposals to SEBI in accordance with the scheme, within 6 months from January 30, 2003, the date of the SEBI Circular.

### ***C. Guidelines for Delisting of Securities on Stock Exchanges***

A committee was constituted on delisting of securities to –

- a. examine and review the present conditions for delisting of securities of companies listed on recognized stock exchanges and suggest changes in norms and procedures in this regard.
- b. examine the concept of listing at regional stock exchange and the establishment of a listing authority across the stock exchanges.

- c. suggest ways for effective implementation of listing conditions and penal provisions for non-compliance

Following the acceptance of the recommendations of the Committee by the SEBI Board, SEBI (Delisting of Securities) Guidelines 2003, were issued on February 17, 2003.

Some of the salient features of the guidelines are –

- a. Applicability to any acquisition of shares of the company (either by a promoter or by any other person) or scheme or arrangement, by whatever name referred to, consequent to which the public shareholding falls below the minimum limit specified in the listing conditions or listing agreement that may result in delisting of securities.
- b. Companies are not permitted to use the buy-back provision to delist its securities.
- c. No longer would there be any stock exchange designated as regional stock exchange.
- d. A company can delist the securities from all the stock exchanges including the regional stock exchange provided that the securities of the company have been listed for a minimum period of 3 years on any stock exchange.
- e. An exit price for delisting of securities would be determined through book building process, which will be made available through the stock exchange terminals.
- f. Such opportunity need not be given in cases where securities continue to be listed in a stock exchange which has nation wide trading terminals viz. BSE, NSE or any other stock exchange specified by SEBI.



#### ***D. Unique Client ID***

The brokers were required to use unique client codes for all clients for order values over Rs. 1 lakh. The stock exchanges were required to deactivate the trading terminals of the brokers, who do not comply with the norms of unique client code from January 01, 2003. As there is no single identity code for investors in India, such as the social security number available in many countries, the code could be passport number, ration card, driving license or PAN Card, with a provision available on stock exchanges for mapping to establish one to one correspondence. SEBI is in discussion with NSDL to work out a system of providing unique number to all investors. NSDL has been entrusted by the Government to set up the registry of the Tax Payer Information Network.

#### ***E. Risk Containment Measures***

##### **a) Withdrawal of margins**

In response to the volatility witnessed in the markets in March 2001, margins were levied on the institutional trades and volatility margins were made applicable to the positions of financial institutions, foreign institutional investors, banks and mutual funds. With the implementation of the VaR based margins, the institutional business continued to be margined on their net outstanding sale position which was equivalent to the positive differential between the minimum VaR (1.75 times index VaR) and the actual margin percentage calculated.

Considering that the market structure and the overall margin system witnessed a major structural change with the implementation of rolling settlement on T+5 basis and further reduction to T+3, the margins applicable on the financial institutions, FIIs, banks and mutual funds were withdrawn.

##### **b) Removal of price bands**

As a temporary measure, a price band of 10 per cent was imposed on 53 scrips on which the derivatives products were available to address excess market volatility pursuant to the events of September 11, 2001 in the US. The price band on the stocks on which derivatives products were available was subsequently withdrawn.

##### **c) Threshold for maintenance of minimum margin deposit**

The clients have to maintain a margin deposit with the broker which is atleast 10 per cent of his net outstanding positions at any point of time. The deposit was to be maintained in the form of cash, bank guarantees, fixed deposit receipts or approved securities. It was represented that this called for continuous monitoring and caused considerable inconvenience to the clients. In view of the representation, an exemption was granted for clients for collection of 10 per cent upfront margin to the extent of Rs 50, 000, i.e., only if a client's position exceeds Rs 5lakhs, the broker would necessarily collect the 10 per cent upfront margin.

The compliance officer appointed by the broker in terms of regulation 18A of the Securities and Exchange Board of India, (Stock Brokers and Sub-Brokers) Regulations, 1992 shall certify the compliance of the broker with this requirement.

##### **d) Risk Management for T+2 rolling settlement**

The risk containment measures were revised and rationalized for the reduced T+2 rolling settlement. Pursuant to the deliberations of the Advisory Committee on Derivatives and Market Risk Management the revised risk containment measures were implemented with effect from April 01, 2003. The scrips were classified into three categories based

on their liquidity and volatility. Based on the classification of the scrips, the VaR based margins were applicable for these scrips.

#### ***F. Model Rules Prescribed For Stock Exchanges***

The committee set up by SEBI to examine the existing Articles and Memorandum of Association, Rules, Bye-laws and Regulations of Stock Exchanges and to frame a uniform set of Rules and Bye-laws to be followed by all the stock exchanges, has submitted its report. The report alongwith the recommendations has been put up on SEBI website for public comments. After examining these comments, SEBI issued a circular to the stock exchanges, to amend their rules in line with the recommendations.

#### ***G. Trading of Government Securities on the Stock Exchanges***

Trading in government securities on nation wide anonymous, order driven, and screen based trading system of the stock exchanges, was launched by Hon'ble Minister of Finance and Company Affairs. India is the first jurisdiction, which allows government securities to trade through screen based, automated, anonymous, price time priority system on the stock exchanges. World over the market is limited to select players and is solely a negotiated/ telephone market. All government securities, as notified by RBI from time to time, would be traded along with the equity segment of the eligible exchanges where the minimum order size of 10 units of Rupees One hundred each and multiples there of and the traded price would be inclusive of interest.

#### ***H. Amendments to Listing Agreement***

To compensate the aggrieved party for opportunity losses due to delay in transfer, the clause 12A has been amended to provide for the compensation to the investors in case

of delay in transfer of securities and furnishing of objection memo beyond the specified time.

#### ***I. Continuous disclosures for Listed Companies***

Accounting Standards Committee of SEBI recommended the following disclosures to further enhance the quality of disclosures and timely availability of information for the investors :

##### ***a. Amendment to Clause 41 of the Listing Agreement***

Clause 41 that provides for continuous disclosures and financial disclosures was amended as follows :

- i Publication of audited results:* The companies which opt to publish audited results for the entire year within 3 months instead of publishing un-audited results for the last quarter within 30 days are required to publish annual audited results in the prescribed format.
- ii Audit Qualification:* The companies would have to make disclosures regarding audit qualification in the audited/unaudited financial results published by the companies along with the impact of audit qualification on their profit & loss.
- iii Limited Review for un-audited quarterly results:* The unaudited quarterly results would also be subjected to limited review from the quarters ending on or after June 30, 2003. In this regard, all other provisions relevant to half yearly limited review became applicable to limited review of unaudited quarterly results.
- iv Publication of consolidated financial results:* All listed companies would have to publish consolidated financial results along with standalone annual financial results.

##### ***b. Clause 32 of the Listing Agreement***

The clause 32 of listing agreement which provides for continuous disclosures was

amended to incorporate certain disclosures related to loans/advances and investment in its own share by listed companies, their subsidiaries, associates, etc. This is expected to bring in a greater degree of transparency in the investments made by companies in shares and debentures :

- a) Disclosure will have to be made in the annual accounts of the parent company about the loans and advances in the nature of loans to subsidiaries and associates by name and amount. The parent company would also have to disclose loans and advances in the nature of loans by name and account where there is no repayment schedule/repayment beyond 7 years or where there is no interest/interest less than Section 372A of Companies Act. Disclosures will also have to be made on loans and advances in the nature of loans by name and account given to firms and companies where directors of the parent company are interested. The same set of disclosures as applicable to parent company shall also be applicable to subsidiary companies.
- b) The investments by the loanee in the shares of parent company and subsidiary company, when the company has made a loan or advance in the nature of loan has to be disclosed in the accounts of parent company. These disclosures have to be made with respect to the amounts at the year end and maximum amount of loan/advances/investments outstanding during the year.

The above set of disclosures became necessary as SEBI investigations have revealed that a large number of shell investment companies are floated by corporate houses wherein, directors are employees of these corporates or are the nominees of the Chartered Accountants/

Financial Consultants. These investment companies act as fronts for the corporate and large industrialist house and are used for routing of funds into the stock market into various layers. These investment companies thus provide a façade for the promoters of the industrial house who carry out transactions which are not allowed or are in contravention of various rules and regulations under SEBI Act, 1992, SC(R) Act, 1956, Indian Companies Act, 1956 etc.

#### ***J. Electronic Data Information Filing and Retrieval (EDIFAR):***

The Electronic Data Information Filing and Retrieval (EDIFAR) System was launched in July 2002. EDIFAR was set up as a website by SEBI in association with National Informatics Center (NIC) to facilitate filing of certain documents/statements by the listed companies on line in the EDIFAR web-site- [www.sebiedifar.nic.in](http://www.sebiedifar.nic.in). This would enable electronic filing of information in a standard format by the companies and would benefit various classes of market participants like investors, regulatory organization, research institutions, etc.

Initially the company would be allowed to file the documents both physically with the stock exchanges and electronically on the web site. Till March 31, 2003, 1750 companies were brought within the scope of EDIFAR. It is intended that after gaining experience and further refining the website and filing procedure as well as the security aspect, the physical filing will be discontinued.

#### ***K. Review of Corporate Governance***

SEBI constituted a new committee on corporate governance under the chairmanship Shri N.R.Narayana Murthy to have a fresh look on the corporate governance with a view to further improving the corporate governance standards, to review the adequacy of the existing requirements of the corporate

governance and suggest revisions / improvements, wherever necessary. The Committee has submitted its report to SEBI which is under consideration .

Meanwhile, SEBI has worked with the credit rating agencies to prepare “Corporate Governance Index” as a measure of wealth creation, management and its distribution by the corporates. Some companies have already been rated on this index. At present the index is voluntary. It is expected that over time, as more and more companies will get themselves rated voluntarily and the rating methodology is refined. This index would be regarded as a valuable indicator of corporate governance of companies and will be widely used by the market.

#### ***L. Restructuring of Subsidiary Management***

SEBI, has allowed the stock exchanges to float subsidiaries to obtain the membership of BSE and NSE. Through this measure, the brokers in the same stock exchange which had virtually no trading could trade through NSE and BSE. To ensure that subsidiaries effectively discharge their responsibilities towards investors protection, SEBI mandated certain changes in management structure of the subsidiaries. The subsidiary companies would be required to comply with the minimum stipulated requirements in order to ensure that the transactions in subsidiaries are conducted in a manner which is not detrimental to the interest of the investors and to enable subsidiaries to provide a safe and transparent mechanism for transaction in securities.

#### ***M. Arbitration Proceedings***

It has been noted that arbitration proceeding take unduly long time to reach the stage of arbitration awards. The procedure provided under the Bye Laws of the stock exchanges for distributing the assets after the award has been granted, are too cumbersome and

further delay the completion of the proceedings. There has been some refinement in the arbitration proceedings.

Arbitration Tribunal to make arbitral award within three months from the date of the reference and the time taken to make the award not to extend more than three times and even if three extensions are sought in a particular case, the arbitration award should be passed within a period of six months from the date of entering into a reference. In other words, extension of time of award can be for a maximum period of three months.

#### ***N. Monitoring Compliance of SEBI Inspection Report***

To simplify the procedures and to ensure that the arbitration proceedings are completed speedily, SEBI issued a directive to the stock exchanges requiring the stock exchanges to form a sub-committee of Governing Board of Stock Exchanges shall comprising of Executive Director/Managing Director, two public representatives, one SEBI nominee and one broker representative to review the actions taken by the stock exchange to implement the suggestions of SEBI’s Inspection Report.

This Committee should meet at least twice each quarter to review the actions taken to implement the suggestions of SEBI’s inspection report and put up same to the Board of the Exchange. The Sub-Committee is required to approve all the compliance reports sent by the Stock Exchange to SEBI related to inspection. To strengthen SEBI’s internal systems of inspection and follow-up, SEBI set up a separate division for inspection and monitoring.

#### ***O. Private Placements***

SEBI Secondary Market Advisory Committee recommended a regulatory framework for issuance and trading of all corporate debt



securities, including those issued through the private placement route. These have been placed on the website of SEBI for public comments.

### **P. Derivatives**

The SEBI Advisory Committee on Derivatives reviewed the report of the Dr. L.C.Gupta committee on derivatives in the context of the present market structure which is vastly different from the time the recommendations were made by Dr. L.C.Gupta Committee. The advisory committee reviewed the eligibility criteria for stocks on which derivatives are traded. The recommendation of the advisory committee were placed on the SEBI website for public comments. SEBI, after examining the public comments accepted the recommendations. Accordingly, the previous eligibility criteria was based on the turnover, market capitalisation, minimum non-promoter holding and volatility of the stock vis-à-vis the index. These were replaced by liquidity, market capitalization, average daily traded volume and quarter sigma order size.

Simultaneously, the risk containment measures were also modified with the change in the eligibility criteria. It has now been linked to the impact cost of the underlying scrip. The Derivatives Exchange/ Segment can also now determine the manner of adjustment in derivative contracts at the time of corporate actions.

The Advisory Committee on Derivatives had recommended that SEBI and RBI should consider utilising the exchange platform to introduce Interest Rate and Currency Derivatives. RBI had constituted a committee on OTC Rupee Derivative where SEBI was also a member. The committee recommended introduction of exchange traded Interest Rate derivative contracts. Steps are underway to introduce such derivatives shortly.

The Derivative Exchange Segments are now required to work out an appropriate policy for inspecting its members and the stipulation of 100 percent inspection has been removed.

Mutual Funds have been allowed to participate in Derivatives trading for the purpose of hedging and portfolio balancing. Committee on Derivatives has clarified the types of transactions which may be considered as hedging and portfolio balancing. These have been clarified based on the recommendations of the committee.

### **III. Mutual Funds**

SEBI initiated a number of policy measures in the year 2002-03 to safeguard the interests of investors in mutual funds and to develop and regulate the mutual fund industry and thus achieving the objectives as specified in the SEBI Act, 1992.

#### **A. Corporate Governance/ Professionalism in Operations of Mutual Funds**

SEBI introduced a number of measures to improve corporate governance standards and professionalism in the mutual funds industry.

##### **a. Benchmarks for Mutual Funds Schemes**

In order to provide the investors objective analysis of the performance of the mutual fund schemes in comparison with the rise and fall in the markets, the mutual funds were advised to disclose the performance of benchmark indices also while publishing half-yearly results. These benchmark indices can be decided by the AMCs and trustees and any change at a later date is required to be recorded and reasonably justified.

The boards of AMCs and trustees were also advised to review the performance of their schemes on periodical basis and compare the performance of their schemes with benchmarks in all of their meetings. They

should also review the performance of their schemes in the light of performance of the mutual funds industry as published from time to time by independent research agencies and financial newspapers and journals and to take corrective action in case of unsatisfactory performance. While guidelines for benchmarks for equity oriented schemes were issued in March 2002, guidelines for benchmarks for debt-oriented schemes and balanced fund schemes were issued in April 2002.

*b. Introducing Best Practices Standards - Certification and Code of Conduct for Mutual Funds Intermediaries*

Intermediaries play a very important role in distribution of mutual funds units. They interact with investors and advise them for making investment in various mutual funds schemes. SEBI took a number of measures to improve the quality of intermediaries and also that they do not indulge in unethical practices.

SEBI (Mutual Funds) Regulations, 1996 specify that mutual funds should not use any unethical means to sell, market or induce any investor to buy their scheme. Further the Regulations also require that mutual funds should maintain high standards of integrity and fairness in all their dealings, render at all times high standards of service and exercise due diligence. In furtherance of these objectives, SEBI has made it mandatory for all distributors and agents to pass certification examination and to follow SEBI (Mutual Funds) Regulations with specific focus on regulations/ guidelines on advertisements/ sales literature and code of conduct. SEBI has also advised the mutual funds to monitor the activities of their agents/distributors to ensure that they do not indulge in any kind of malpractice or unethical practice while selling / marketing mutual fund units.

The distributors and agents must follow the detailed code of conduct as recommended by AMFI. If any intermediary does not comply

with the code of conduct, the mutual funds are required to report it to AMFI and SEBI. No mutual fund allowed to deal with those intermediaries who do not follow the code of conduct. The intermediaries have been advised not to share commission with investors. Investors should subscribe to units of a mutual fund on the basis of merits and performance and not on the basis of quantum of commissions.

All intermediaries engaged in selling and marketing of mutual fund units were required to be registered with AMFI. Such registration will be subject to passing of certification examination and adherence to guidelines as specified by SEBI and AMFI from time to time. However, senior citizens with experience in distributing mutual funds units have been allowed exemption from certification examination. They should have completed 60 years of age as on March 31, 2003 and should have two years of experience. They should follow SEBI and AMFI guidelines and should be registered with AMFI. They should also attend a mutual fund training programme within one year from March 31, 2003 and a certificate to that effect endorsed by a mutual fund should be submitted to AMFI.

The mutual funds are required to monitor the compliance of these guidelines and code of conduct by their intermediaries in terms of business done across all mutual funds. In case of non-compliance, the empanelling mutual funds may suspend further business and pay out of commissions, etc. until full compliance by them.

*c. Applicability of Insider Trading Regulations (2002)*

The trustee companies, asset management companies and their employees and directors have been advised to strictly follow the Securities and Exchange Board of India (Insider Trading) (Amendment) Regulations, 2002.



#### *d. Bi-monthly Trustee Meetings*

A number of responsibilities have been assigned to trustees of mutual funds under SEBI (Mutual Funds) Regulations. Therefore, it has been decided that the trustees should meet on bi-monthly basis to review the performance and compliance related issues of their mutual funds, instead of the earlier requirement of meeting on a quarterly basis.

#### *e. Independent Directors on the Board of AMC's and Trustee Companies*

According to SEBI (Mutual Funds) Regulations, 1996, 50 percent of directors of AMC and two-third of the trustees are required to be independent i.e. who are not associates of the sponsors. With an objective to improve corporate governance and to bring about transparency in the operations of the mutual funds, the definition of Independent Directors was revised so that certain categories of persons could not be considered as 'associates' and not as independent directors.

With a view to implementing the regulation in letter and spirit and improving corporate governance standards in mutual funds, it has been clarified to mutual funds that persons providing any type of professional service to the mutual fund, asset management company, trustee company and sponsors shall be considered as associate directors of AMCs or trustee companies, as the case may be. Also, persons having any material pecuniary relationship with these entities, which in the judgement of the trustees may affect independence of directors, shall be treated as associate directors.

At times, an unduly long period of time elapses before an outgoing independent director is replaced on the board of AMC. After discussions in SEBI Advisory Committee, the mutual funds were advised to appoint independent director(s) in place of the

outgoing director(s) within a period of 3 months from the date of resignation. The Mutual funds were also advised to maintain a panel of eligible persons who could be appointed as independent directors as and when required. Also that they may consider appointing more than the required minimum number of independent directors in order to enhance the standards of corporate governance.

#### *f. Risk Management System*

Guidelines were issued to all mutual funds to ensure a minimum standard of due diligence or risk management system while undertaking various activities by the mutual funds like fund management, operations, customer service, marketing and distribution, disaster recovery and business contingency, etc. The purpose is to eliminate/ minimise the risks in operations of mutual funds. A comprehensive risk management manual was issued to all mutual funds.

#### *g. Strengthening Roles of Chief Executives and Fund Managers of Mutual Funds*

Chief executives and fund managers of mutual funds play very important role in the functioning of mutual funds. After taking feedback from chief executives and fund managers from all mutual funds, the SEBI defined their roles in SEBI (Mutual Funds) Regulations, 1996.

Accordingly the Chief Executive Officer (whatever the designation may be) of the asset management company is required to ensure that the mutual fund complies with all the provisions of SEBI (Mutual Fund) Regulations, 1996 and the guidelines issued thereunder and that the investments made by the fund managers are in the interests of the unitholders. He/ She shall also be responsible for the overall risk management function of the mutual fund. The fund manager (whatever the designation may be) is also required to ensure

that the funds of the mutual fund schemes are invested to achieve the objective of the scheme and in the interests of the unitholders.

The objective of these measures is to enable the chief executives and fund managers of mutual funds to play their roles in the interest of investors without any influence and pressures.

*h. Transactions of Mutual Funds in the Government Securities in Dematerialised Form and their Reconciliation*

All mutual funds have been advised to enter into transactions relating to government securities only in dematerialised form. They have also been advised to reconcile their accounts with the RBI periodically.

In order to make the transactions in government securities transparent without any scope of misuse, it has been decided in consultation with RBI to introduce a system of monthly reconciliation between RBI and mutual funds maintaining SGL/CSGL Accounts in respect of government securities on an ongoing basis. The Public Debt Offices of RBI will issue monthly statement of balances to the mutual funds, which are to be reconciled by the mutual funds for the transactions undertaken by them. The reconciliation procedure shall be made a part of internal audit and the auditors shall check, on a continuous basis, about the status of reconciliation and submit a report to the Audit Committees. These reports are also to be placed in the meetings of boards of AMCs and trustees. These measures would prevent any major loss arising out of non-reconciliation of government securities.

**B. Prudential Investment and Valuation Norms**

*a. Guidelines for Valuation of Unlisted Equity Shares*

SEBI issued guidelines for the valuation of unlisted equity shares with a view to bringing

about uniformity in the calculation of NAVs of the schemes by all mutual funds. The guidelines prescribe detailed methodology for valuation of unlisted equity shares based on stringent pricing formula. The mutual funds have been prohibited from buying unlisted equity shares at a price higher than that worked out in accordance with the methodology. Guidelines also prescribe exercise of due diligence while making such investments.

*b. Treatment and Disposal of Illiquid Securities/ NPAs at the Time of Maturity/ Closure of the Scheme*

Some of the investments made by mutual funds may become non-performing assets (NPAs) or illiquid at the time of maturity / closure of the schemes, which may be realised by the mutual funds in due course i.e. after winding up of the scheme.

SEBI issued guidelines during the year and the mutual funds were advised to distribute such amount, if it is substantial and is realised within two years, to the old investors. In case the amount is not substantial or it is realised after two years, it may be transferred to the Investor Education Fund maintained by each mutual fund. The decision as to determination of substantial amount is to be taken by the trustees of the mutual funds after considering relevant factors.

*c. Investment Valuation Norms*

According to the investment valuation norms specified in the SEBI (Mutual Funds) Regulations, any change in securities and in the number of units is to be recorded in the books not later than the first valuation date following the date of transaction. If this is not possible given the frequency of the net asset value disclosure, the recording may be delayed upto a period of seven days following the date of the transaction, provided

that as a result of non-recording, the NAV calculation shall not be affected by more than two percent. As a result, the investors of a scheme may be affected by variation of two percent in the NAV. This variation of two percent was now felt to be on the higher side. As improvement in systems and technology over the years, should make it possible for the mutual funds to calculate the NAV accurately than what was when the rate was formulated so as that the investors may enter or exit at sale and repurchase prices based on NAV which is very near to the actual NAV.

SEBI Regulations have been amended to reduce the allowable variation in NAV from the present '2 percent' to '1 percent'. The Regulations also now require that in case the NAV of a scheme differs due to non-recording of transactions by more than one per cent, the investors or schemes shall be compensated. If investors are allotted units at higher NAV or they are given lower NAV at the time of their sale of units, they should be compensated by the schemes. However, if investors are charged lower NAV at the time of their purchase of units or they are given higher NAV at the time of their sale of units, asset management company shall compensate the schemes.

#### *d. Accuracy and Uniformity in Valuation*

Uniformity and accuracy in valuation by the mutual funds is necessary. If each mutual fund has its own valuation methods, it is very much likely that two mutual funds in spite of having same portfolios would have different NAVs. Therefore, SEBI has been issuing valuation guidelines from time to time.

During the year 2002-03, SEBI issued further guidelines that all mutual funds shall provide transaction details of various types of debt securities like NCDs, Mibor Linked floaters and CPs on a daily basis in the prescribed format to the agency recommended by AMFI.

Submission of data would help in daily matrix generation, improve uniformity and accuracy of valuation in the mutual funds industry.

### **C. New Products/ Activities**

#### *a. Investment in Foreign Securities*

The investments limit on foreign securities has been raised from the earlier limit of four percent of net assets (as on February 28, 2002) to 10 percent of net assets of each mutual fund as on January 31, 2003. However a minimum of US\$ 5 million and maximum of US\$ 50 million is permissible to each mutual fund irrespective of size of assets. It was also clarified to the mutual funds that the regulations which restrict investments in mutual fund units upto five percent of net assets and prohibits charging of fees is not applicable to investments in mutual funds in foreign countries. The management fees and other expenses charged by mutual fund(s) in foreign countries along with the management fee and recurring expenses charged to the domestic mutual fund scheme should not exceed the total limits on expenses prescribed under the Regulations. Where the mutual fund is investing only a part of the net assets in the foreign mutual fund(s), the same principle is applicable for that part of the investment. The details of the calculation for charging such expenses is to be reported to the Boards of AMC and trustees and is to be disclosed in the annual report of the scheme.

Mutual funds have also been permitted to invest in the equity of listed overseas companies subject to certain restrictions. Necessary guidelines have been issued to mutual funds.

#### *b. Clarifications for Participation by Mutual Funds in Trading in Derivatives*

Guidelines for participation by mutual funds in trading in derivatives were issued on

February 9, 2002. The SEBI Advisory Committee on Derivatives clarified certain types of transactions with illustrative examples which could be considered by mutual funds as hedging and portfolio balancing. Necessary clarifications were issued to mutual funds.

### *c. Fund of Funds*

A fund of funds (FoFs) is a mutual fund scheme that invests in schemes of other mutual funds instead of investing in securities. They may invest in equity-oriented, debt-oriented and liquid schemes or sector specific schemes. They may also exit from a particular scheme depending on their perception of market conditions which may not be possible for an investor to decide.

Investors may invest in a particular FoF scheme depending on their investment objectives instead of investing in a number of schemes. Such schemes would be subject to (i) maximum limit on expenses to the extent of 0.75 per cent of net assets and (ii) certain restrictions and disclosures in SEBI (Mutual Fund) Regulations, 1996 which are in the process of being notified.

## **D. Improvement in Disclosure Standards**

SEBI has taken a number of steps over the years in the area of disclosures so that the investors may take well informed investment decisions. During the year 2002-03, SEBI initiated the following measures:

### *a. Portfolio Disclosure*

While making half-yearly portfolio disclosures, mutual funds have been advised to make certain disclosures in the equity and debt oriented schemes. In case of equity-oriented schemes, the mutual funds are required to disclose the portfolio turnover ratio as a footnote and the name of the industry against

the name of each security in accordance with industry classification as recommended by AMFI. The same industry classification can also be followed by the mutual funds while making disclosure of portfolios to investors, distributors and others, which are non-statutory in nature. Further, in case of debt-oriented schemes, the average maturity period is required to be disclosed as a footnote.

### *b. Simplification of Disclosure in Offer Documents*

The standard offer document for mutual funds prescribed in April 1998 inter-alia requires disclosure of all penalties imposed on the sponsor/AMC or their associates. Many mutual funds who have a very long history or a large number of associate entities with many of them based in various countries had expressed their difficulty in collating the required information and updating the same on a continuous basis. In view of this genuine concern, SEBI reviewed the requirement of disclosure on penalties in consultation with mutual funds industry. The modified disclosure criteria was finalised and communicated to all the mutual funds. SEBI made sure that the difficulty in collecting information would be minimized without sacrificing the requirement of disclosing the regulatory conduct of the group.

### *c. Other Disclosure Requirements*

SEBI also prescribed disclosure requirements for conversion of close ended schemes into open ended schemes and in case of change in controlling interest of mutual funds.

## **E. Investor Servicing**

### *a. Nomination Facility for Unitholders of Mutual Funds.*

SEBI (Mutual Funds) Regulations, 1996 were amended by including a provision for the AMCs to provide an option to the unitholder(s)



to nominate a person in whom the units held by the unitholder(s) can be vested in the event of the death of the unitholder(s). The format for nomination has also been prescribed.

*b. Uniformity in Calculation of Sale and Repurchase Price and Rounding off of NAVs*

All the mutual funds have been advised to follow a uniform method to calculate the sale and repurchase price. The mutual funds must clarify in the offer documents that the loads shall be charged as a percentage of NAV i.e. applicable load as a percentage of NAV will be added to NAV to calculate sale price and will be subtracted from NAV to calculate repurchase price. They are also required to explain the calculation by means of an example.

Apart from bringing about uniformity in the mutual funds industry, it would now be very easy for the investors to calculate their sale / repurchase price.

The mutual funds have also been advised to round off NAV upto four decimal places in respect of index funds and all types of debt-oriented schemes like liquid/money market mutual fund schemes i.e in case of schemes which invest predominantly in money market instruments, gilt, income short term plans, fixed maturity plans, monthly income plans etc. and upto two decimal places in case of equity-oriented and balanced fund schemes. However, the mutual funds can round off NAVs upto more than two decimal places in case of equity-oriented and balanced fund schemes also, if they so desire. This has been introduced so that there is uniformity in the mutual funds industry. The mutual funds are also required to make necessary disclosures in the offer documents.

*c. Effective Investor Grievances Redressal Mechanism*

Investor grievances against mutual funds are handled on priority basis by SEBI. Due to regular monitoring and follow-up, the rate of redressal has always been about 99.5 per cent. The difference of 0.5 per cent is because some of the complaints are under processing i.e. being forwarded to mutual funds, reporting by mutual funds and incorporation in our data base. It may be said that all complaints received from investors against mutual funds are redressed promptly.

**F. Re-Engineering of Systems and Processes**

Several initiatives were taken by SEBI towards re-engineering of systems and processes in the case of mutual funds.

*a. Revised format for Annual Statistical Report (ASR)*

The format of Annual Statistical Report earlier running into several pages was revised and simplified to a one page report, so that we may compile and analyse the data received from mutual funds. The analysis of the data in the ASRs gave industry the opportunity to study distribution of holdings of the mutual fund units by individual investor, corporates, NRI /OCBs, FII trusts., etc. The ASR is available on the SEBI's web site.

*b. New Scheme Reports simplified*

The format for new scheme reports required to be filed by the mutual funds have been simplified and revised. While earlier they were required to file two separate reports, one after closure of scheme and another after allotment, now they are required to file only one report after allotment. While earlier reports were for the purpose of data collection, new format of the report also covers regulatory compliances by the mutual funds.

*c. Quarterly reports on movement in net assets discontinued*

The statement of movement in net assets/ portfolios, in prescribed formats on quarterly basis was discontinued as the purpose was adequately served by other reports submitted by the mutual funds.

*d. Transparency in registration of mutual funds and VCFs/FVCIs*

In order to further streamline the process and shorten the time taken for registration as a mutual fund, we have taken the initiative to post the entire step by step procedure of granting registration on SEBI website under 'Mutual Funds Section' - 'How to get registered as a Mutual Fund'. All information required in addition to that in the application form has been included. SEBI has also mentioned the benchmark time period within which our observation/replies will be communicated to them.

This exercise will greatly help the applicants to understand the procedural formalities in getting registered with SEBI. This will also make registration procedure completely transparent. This will also help the foreign sponsors in various countries.

*e. Cross-reference between Regulations and circulars/guidelines*

SEBI (Mutual Fund) Regulations, 1996 have been modified/ amended and guidelines and clarifications, which have the sanctity of Regulation, have been issued from time to time. To avoid the risk of inadvertent non-compliance and to help the funds to have an integrated view of the updated Regulations and inter-related circulars and guidelines, we have indicated suitable linkages and cross-references to the relevant circulars, schedules and guidelines issued till September 30, 2002. The same has been circulated among the mutual funds and has also been posted in our website under "Mutual Funds Section".

*f. Clarifications on SEBI Regulations and Guidelines*

SEBI issued certain clarifications/ interpretations of regulations to AMFI for circulation among the mutual funds. This will help the existing as well as new mutual funds to understand and interpret the Regulations and guidelines in their true spirit. This initiative is just the beginning. In future also, such clarifications would be issued from time to time.

*g. Conversion of Close ended schemes into open ended schemes*

Guidelines/instructions were issued to the mutual funds to be followed for conversion of close ended schemes into open ended ones. Certain information like past performance of the scheme, comparison with benchmarks, etc must be disclosed in the letter to the unitholders so that they may take well informed investment decisions. Also, the unitholders must be given a period of at least 30 days for the purpose of exercising the exit option.

*h. Procedure for Change in Controlling Interest of Mutual Funds*

After handling such cases, we have evolved certain procedure in this regard. The entire procedure to be followed for obtaining SEBI's approval was put on SEBI website. In cases where there has been change in controlling interest of mutual funds has been placed with SEBI's website.

#### **IV. Venture Capital : Development and Policy Initiatives**

SEBI (Venture Capital Funds) Regulations were notified in 1996. Subsequently, on the basis of recommendations made by the committee set up by SEBI under the chairmanship of Shri K.B. Chandrashekhar, regulations were amended in September 2000. Also, for the first time, regulations for foreign venture capital investors were notified.



Thereafter, SEBI has received some representations/suggestions from the venture capital industry. To deliberate upon these issues, SEBI has set up an Advisory Committee on Venture Capital under the chairmanship of Dr. Ashok Lahiri, Chief Economic Advisor, Ministry of Finance, Government of India.

## **V. Foreign Institutional Investors (FIIs)**

### **A. Simplification of documentation required for registration as an FII**

SEBI(FII) Regulations, 1995 was amended to reduce the requirement for documentation and following list specifies documents required. The registration fee was also reduced to US\$ 5,000 from US\$ 10,000.

### **B. Adoption of Straight Through Processing**

Straight Through Processing ("STP") involves capturing and processing transactions in one pass, from the point of first deal to final settlement. This will obviate the need for manual entry and re-entry of data of trade particulars which is time consuming and prone to errors.

In order to examine the feasibility of STP in the Indian markets, SEBI constituted a committee of representatives from various market intermediaries and the Reserve Bank of India.

The Committee in its report recommended the following:

- a. Adoption of ISO 15022 messaging standards by the market participants
- b. Electronisation of contract notes
- c. Connectivity among the market participants and implementation of STP.

SEBI accepted the Committee's recommendations and introduced STP for

electronic trade processing with a common messaging standard i.e. ISO15022 with effect from December 02, 2002 on a voluntary basis. After gaining some experience it is intended to make STP mandatory across all segments of market.

## **VI. Substantial Acquisition of Shares and Takeovers**

### **A. Amendment to the SEBI (Substantial Acquisition of Shares and Takeovers), Regulations, 1997**

Based on the recommendations made by the Bhagwati Committee, SEBI made certain amendments to the Takeover Regulations on September 9, 2002. Major amendments include -

- a) Removal of automatic exemption for acquisition through preferential allotment.
- b) Additional condition in case of inter se transfer amongst different promoters or groups of promoters added i.e. interse transfers at a price not exceeding 25 per cent price as determined in terms of the provisions of the Regulations alone would merit automatic exemption.
- c) Increased frequency in disclosure of shareholding when it crosses 5 percent, 10 percent and 14 percent.
- d) Disclosure of purchases or sales at every 2 percent level, in respect persons holding between 15 percent and 75 percent.
- e) Change of control through special resolution including giving the facility of voting through postal ballot instead of ordinary resolution.
- f) Dispensation with the requirement of advance submission of copy of draft public announcement to SEBI, stock exchanges and target company.

- g) Additional parameter of two weeks daily average of the high and low of the prices preceding the date of the public announcement for determination of offer price.
- h) Factoring of payment made towards non-compete agreement in excess of 25 percent of the offer price arrived in terms of the Regulations while calculating the open offer price.
- i) Minimum offer size of 20 percent in all cases.
- j) Reduction in creeping acquisition limit from 10 percent to 5 percent with effect from October 01, 2002.
- k) In case of indirect acquisition or change in control, the open offer may be made within 3 months of consummation of such acquisition or change in control or restructuring of the parent or the company holding shares of or control over the Indian target company. However, the offer price has to be determined with reference to the date of public announcement for parent company and date of public announcement for Indian target company and whichever is higher would apply.
- l) Facility of withdrawal of acceptances by shareholders upto three working days before the closure of the offer.
- m) Removal of the facility of withdrawal by the first acquirer in case of a competitive bid.
- n) The shares of the target company would be deemed to be infrequently traded if the trading turnover is less than 5per cent (instead of 2per cent earlier) of the shares listed on the stock exchange.
- o) The relaxations extended for disinvestment of central PSUs have been made applicable for state PSUs as well.
- p) The directions that could be given by SEBI for the various violations have been increased to include :
  - i. Appointment of a merchant banker for the purpose of causing disinvestment of shares acquired in breach of regulations 10, 11 or 12;
  - ii. Transfer of any proceeds or securities to the Investors' Protection Fund of a recognised stock exchange;
  - iii. The target company or depository to cancel the shares where an acquisition of shares pursuant to an allotment is in breach of regulations 10,11 or 12;
  - iv. The target company or the depository not to give effect to transfer or further freeze the transfer of any such shares and not to permit the acquirer or any nominee or any proxy of the acquirer to exercise any voting or other rights attached to such shares acquired in violation of regulations 10, 11 or 12;
- q) Additional parameter of two weeks daily average of the high and low of the prices preceding the date of the public announcement for determination of offer price would not be applicable in the case of disinvestment of a Public Sector Undertaking.

#### ***B. SEBI Regularisation Scheme, 2002***

In terms of Chapter II of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (hereinafter referred to as 'the Takeover Regulations, 1997') certain categories of persons are required to disclose their shareholding and/or control in a listed company to that company. Such companies, in turn, are required to disclose such details

to the stock exchanges where shares of the company are listed. It has been observed that many listed companies and/or their promoters/ shareholders have either not complied at all or have complied with the said requirements after the expiry of the time specified in the said regulations.

In order to enable such persons and companies to comply with these requirements, SEBI introduced a scheme, namely, "SEBI Regularization Scheme, 2002" (hereinafter referred to as 'the Scheme'). Under the Scheme, the persons and companies who have not made disclosures or who have made disclosures after the expiry of the period as specified in the Takeover Regulations, 1997 are permitted to make disclosures to the company and the stock exchange as the case may be, and pay the lump-sum amount specified herein.

The scheme was in force for –

- a) A period of 3 months, i.e. from October 1, 2002 to December 31, 2002 {later on extended to February 28, 2003} , for the shareholders/ promoters of the listed target companies.
- b) A period of 4 months, i.e. from October 1, 2002 to January 31, 2003 {later on extended to March 31, 2003} , for the listed target companies. As of February 28, 2003, 131 companies have participated.

## **VII. Other Policies and Programmes Having a Bearing on the Working of the Securities Market**

### **A. Amendment to the Companies Act, 1956**

- a. Companies (Amendment) Act, 2002
  - i Notified with effect from 6.2.2003.
  - ii It makes provision for registration of certain entities operating on the

basis of mutual assistance as producer companies under the new part IXA of the Companies Act. They will be akin to private limited companies.

### **B. Companies Act – Schedules**

- a. Schedule II of the Companies Act
  - i. The Schedule amended by the Central Government with effect from 17.9.2002, requiring the declaration from the directors of the company inviting subscription from the public that all relevant provisions of the Companies Act and the SEBI Guidelines and Government Guidelines have been complied with and that no statement made in the prospectus is contrary to the Companies Act, the SEBI Act and the rules made or guidelines issued thereunder and the guidelines issued by the Central Government.
- b. Schedule V of the Companies Act
  - i. The Schedule dealing with format of annual return has been altered with effect from 2.11.2002 and now contains a revised certificate stating that all amounts mentioned in section 205C remaining unpaid / unclaimed for a period of 7 years as specified have been transferred to the Investors Education and Protection Fund.
- c. Schedule VI of the Companies Act
  - i The Schedule dealing with the format of balance sheet has been altered with effect from 13.11.2002 to contain details of the amounts credited to the Investors Education and Protection Fund under the head 'Current Liabilities and Provisions'.

- ii Permissible rounding off of the amounts mentioned in the balance sheets have been revised with effect from 1.8.2002.
- iii The limit of paid-up capital for compulsory appointment of Company Secretaries under section 383 A has been raised from Rs.50 lakh to Rs.2 crore. Companies having lesser paid-up capital will have to file the prescribed secretarial compliance certificate.

### ***C. Companies Act – Rules / Amendments Rules / Circulars***

- a. Companies (Issue of Indian Depository Receipts) Rules, 2002.
  - i SEBI has given its detailed comments on the Draft Companies (Issue of Indian Depository Receipts) Rules drafted by the DCA under section 605A of the Companies Act.
- b. The Directors' Relatives (Office or Place of Profit) Rules, 2003
  - i It applies to all offices and places of profits in a company carrying a monthly remuneration of more than Rs. 50,000/- per month. The obtaining of approval of the Central Government for appointment to such offices is mandatory. The factors which the Central Government would take into consideration while granting or refusing approval have been indicated in the Rules.
  - ii By General Circular No. 2 of 2003, the DCA has clarified that the Cost Auditor of a company can take part in the meeting of its Audit Committee in his capacity as an internal auditor, but cannot become

a member thereof and cannot exercise voting rights therein.

### ***D. Amendment to the Securities and Exchange Board of India Act, 1992***

The Securities and Exchange Board of India Act, 1992 has been amended by Securities and Exchange Board of India (Amendment) Act, 2002 with effect from 29.10.2002 :

#### ***a. Management of the Board***

- i The Board shall consist of a Chairman, two members from amongst Officials of the Ministry of the Central Government dealing with Finance and Administration of the Companies Act, one member from the Reserve Bank and five other members of whom atleast three shall be whole-time members, to be appointed by the Central Government.
- ii The composition of the Board has been increased to nine members with further provision that out of five members other than those from the Central Government and the Reserve Bank, atleast three shall be whole-time members.
- iii After the amendment the representative of the Central Government on the Board shall not be from the Ministry of Law.

#### ***b. Functions of the Board***

- i The Board has been conferred powers to call for information and record from any Bank or other Authority or Board or Corporation constituted under any Central or State Act in respect of any transaction in securities which is under investigation or enquiry by the Board.

- ii Section 11 (2A) empowers the Board for taking measures to undertake inspection of any book or register or document or record of any listed company or a public company which intends to get its securities listed on a recognised stock exchange, if the Board has reasonable grounds to believe that such company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market.
- iii Section 11(3) further extends the power of a Civil Court to the Board in respect of inspecting any book or register or document or record of a listed company or a public company which intends to get its securities listed on a recognised stock exchange and in respect of issuing commissions for the examination of witnesses.
- iv The Board has been conferred powers for passing an order for reasons to be recorded in writing, in the interest of investors or securities market, either pending investigation or enquiry or on completion of such investigation or enquiry for taking any of the following :
  - Suspend the trading of any security in any recognised stock exchange.
  - Restrain persons from accessing the securities market and prohibit any person associated with the securities market to buy, sell or deal in securities.
  - Suspend any office bearer of any stock exchange or self regulatory organization from holding such position.
  - Impound and retain the proceeds or securities in respect of any transaction which is under investigation.
  - Attach one or more bank account of any intermediary or person associated with the securities market in any manner involved in violation of any of the provisions of the Act, Rules or Regulations. However, such order of attachment can be made by the Board only after passing of an order by a Judicial Magistrate of the First Class on an application made for the approval. Further, such order of attachment can be made only for a period not exceeding one month and that only the bank account so far as it relates to the proceeds actually involved in violation of the provisions of the Act, Rules, or Regulations shall be allowed to be attached.
  - Direct any intermediary or any person associated with the securities market in any manner not to dispose off or alienate an asset forming part of the transaction which is under investigation.
- v The Board may, for the protection of investors, by general or special orders -
  - Prohibit any company from issuing prospectus, any offer document, or advertisement soliciting money from the public by the issue of securities;
  - Specify the conditions subject to



which the prospectus, such offer document or advertisement, if not prohibited, may be issued.

- vi The Board may specify the requirements for listing and transfer of securities and other matters incidental thereto.

*c. Investigation*

- i The Board may, by an order in writing, direct any person to investigate the affairs of such intermediary or persons associated with the securities market and to report thereon to the Board.
- ii It shall be the duty of every manager, managing director, officer and other employee of the company and every intermediary to preserve and to produce to the Investigating Authority all the books, registers, other documents and record of, or relating to, the company or, as the case may be, of or relating to, the intermediary or such person, which are in their custody or power.
- iii The Investigating Authority may require the concerned persons to furnish such information to, or produce such books, or registers, or other documents, or record before him.
- iv The Investigating Authority may keep in its custody any books, registers, other documents and record for six months and thereafter shall return the same to the concerned persons by whom or on whose behalf the books, registers, other documents and record are produced. The Investigating Authority may call for any book,

register, other document and record if they are needed again.

- v The Investigating Authority may examine on oath, any manager, managing director, officer and other employee of any intermediary or any person associated with securities market in any manner, in relation to the affairs of his business and may administer an oath accordingly and for that purpose, may require any of those persons to appear before him personally.
- vi If any person fails without reasonable cause or refuses to produce to an Investigating Authority any book, register, other document and record or to furnish any information which it is his duty or to appear before the Investigating Authority personally when required to do so or to answer any question which is put to him by the Investigating Authority or to sign the notes of any examination he shall be punishable with imprisonment for a term which may extend to one year, or with fine, which may extend to one crore rupees, or with both, and also with a further fine which may extend to five lakh rupees for every day after the first during which the failure or refusal continues.
- vii The Investigating Authority may, pursuant to an order made on an application by the Judicial Magistrate of the first class having jurisdiction-
  - enter the place or places where such books, registers, other documents and record are kept;



- search that place or those places in the manner specified in the order ; and
- seize books, registers, other documents and record it considers necessary for the purposes of the investigation.

viii Seizure of books, registers, other documents and record, of listed public company or a public company (which is not an intermediary which intends to get its securities listed on any recognized stock exchange) is not permitted unless such company indulges in insider trading or market manipulation.

#### *d. Cease and Desist proceedings*

- i If the Board finds, after causing an inquiry to be made that any person has violated, or is likely to violate, any provisions of this Act, or any rules or regulations made thereunder, the Board may pass an order requiring such person to cease and desist from committing or causing such violation.
- ii Board shall pass such order in respect of listed public company or a public company which intends to get its securities listed on any recognized stock exchange only if such company has indulged in insider trading or market manipulation.

#### *e. Prohibition of Manipulative and Deceptive Devices, Insider Trading and Substantial Acquisition of Securities or Control*

The following activities have been prohibited -

- i use or employment of any manipulative or deceptive device or contrivance in contravention of the

provisions of this Act or the rules or the regulations made there under;

- ii employment of any device, scheme or artifice to defraud in connection with issue or dealing in securities ;
- iii engaging in any act, practice, course of business which operates or would operate as fraud or deceit upon any person, in connection with the issue, dealing in securities in contravention of the provisions of this Act or the rules and the regulations made there under;
- iv engaging in insider trading;
- v dealing in securities while in possession of material or non-public information or communicating such material or non-public information to any other person, in a manner which is in contravention of the provisions of this Act or the rules and the regulations made there under;
- vi acquiring control of any company or securities more than the percentage of equity share capital of a listed company in contravention of the provisions of this Act or the rules and the regulations made there under.

#### *f. Penalties and Adjudication*

- i The penalties to be imposed by Adjudicating Officer have been enhanced so as to serve as effective deterrents.
- ii The sum realized by way of penalties shall be credited to the Consolidated Fund of India.

#### *g. Establishment of Securities Appellate Tribunal (SAT)*

- i The Securities Appellate Tribunal shall consist of a Presiding Officer and two other members.

- ii A person, who is a sitting or retired Judge of the Supreme Court or a sitting or retired Chief Justice of a High Court, may be appointed as Presiding Officer in consultation with the Chief Justice of India or his nominee.
- iii A person who is a person of ability, integrity and standing who has shown capacity in dealing with problems relating to securities market and has qualification and experience of corporate law, securities laws, finance, economics or accountancy shall be qualified for appointment as Member
- iv A member of the Board or any person holding a post at level equivalent to Executive Director in the Board shall not be appointed as Presiding Officer or Member of a Securities Appellate Tribunal during his service or tenure as such with the Board or within two years from the date on which he ceases to hold office as such in the Board.
- v The Presiding Officer, Members and other officers and employees of the Securities Appellate Tribunal shall be deemed to be public servants.
- vi Appeal to Supreme Court- Against any decision or order of the Securities Appellate Tribunal an appeal shall to the Supreme Court.
- vii Such appeal may be filed by the aggrieved party within sixty days from the date of communication of the decision or order on any question of law arising out of such order.

#### *h. Offences*

- i The penalties for offences under the Act enhanced to ten years, or with

fine, which may extend to twenty-five crores rupees or with both.

#### *i. Compounding of Offences*

- i Any offence punishable under the Act, not being an offence punishable with imprisonment only or with imprisonment and also with fine may either before or after the institution of any proceeding, be compounded by a Securities Appellate Tribunal or a court before which such proceedings are pending.

#### *j. Power to Grant Immunity*

- i If on recommendation by the Board, the Central Government is satisfied that any person, who is alleged to have violated any of the provisions of this Act or the rules or the regulations made thereunder, has made a full and true disclosure in respect of the alleged violation, it may grant to such person, subject to such conditions as it may think fit to impose, immunity from prosecution for any offence under this Act, or the rules or the regulations made thereunder or also from the imposition of any penalty under this Act with respect to the alleged violation.
- ii No such immunity can be granted in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of application for grant of such immunity.
- iii An immunity granted to a person may, at any time, be withdrawn by the Central Government, if it is satisfied that such person had, in the course of the proceedings, not

complied with the condition on which the immunity was granted or had given false evidence.

**k. Cognizance of Offences by Courts**

- i A court of the rank of a Court of Session shall try an offence punishable under the Act.

**E. SEBI Regulations and Amendment to SEBI Regulations**

Some of the amendments have been listed in the chapter. This section describes the amendments in greater details.

**a. SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 were notified on 27.9.2002 vide S.O. No.1045 (E).**

- i The provisions regarding enquiry proceedings provided under the various regulations deleted.
- ii A common and comprehensive procedure of enquiry and imposition of penalty provided.
- iii The Enquiry Officer may be appointed by the Chairman or a member designated in this behalf in the matter involving technical or complicated questions of fact or law. The Chairman or the member may appoint more than one Enquiry Officer to function as a bench presided over by the Senior amongst them.
- iv The notice may be served by Registered Post by A.D. or by the courier service approved by the board. If the notice cannot be served by these modes the same may be served by affixing the same on the door or some other conspicuous part of the premises of

the registered office or the principal office of the intermediary. In case of a stock broker the notice shall be served through the concerned stock exchange.

- v The intermediary may appear before the Enquiry Officer through an authorized representative who is not a legal practitioner unless the Chairman or the member has appointed a legal practitioner as presenting officer.
- vi The Enquiry Officer may recommend minor penalties or major penalties by giving justification therefor.
- vii The minor penalties and major penalties have been defined. Minor penalties include warning, prohibiting the intermediary to take up any new assignment upto six months, suspension of certificate for a period upto three months etc. The major penalties include cancellation of certificate, suspension for a period exceeding three months, prohibiting or debarring the intermediary for a period exceeding six months.
- viii The grounds for imposing of major penalties prescribed.
- ix The Chairman or the Member may pass the appropriate order after considering the reply to the show cause notice issued to the intermediary after the report of the enquiry officer.
- x If the Enquiry Officer recommends minor penalty and the Chairman or the member proposes to impose major penalty, a notice to make written submissions within 15 days and after considering the written submissions if any, the Chairman or the Member may pass suitable order.

- xi A summary procedure has been provided in case of certain circumstances involving established facts as provided in the regulations.
- xii For the summary procedure, the Chairman or the Member may appoint an officer of the Board not below the rank of Division Chief to pass appropriate orders under the circumstances specified in the regulations in this behalf. The officer so appointed shall give a notice to the concerned intermediary for making written submissions. After considering the written submissions the officer shall pass appropriate orders.
- xiii The orders passed under the regulations are to be published by issue of press release in respect of the order in two newspapers of which atleast one shall have nationwide circulation. The order shall also be put on the website of the Board.

***b. SEBI (Central Listing Authority) Regulations, 2003***

These regulations were notified on 13th February, 2003 vide S.O. No. 171 (E).

- i A Central Listing Authority (CLA) shall be constituted by the SEBI.
- ii The CLA shall have the functions of issuing or rejecting the application made by any body corporate, mutual fund or collective investment scheme for letter of recommendation for listing, of making recommendations as to listing conditions and of discharging such other functions as may be specified by SEBI from time to time.
- iii Before making an application for listing to any stock exchange, a

body corporate, mutual fund or collective investment scheme shall obtain a letter of recommendation for listing from the CLA on an application made in that behalf.

- iv An exchange shall not consider any listing application made by any body corporate, mutual fund or collective investment scheme, unless it is accompanied by a letter of recommendation issued by the CLA.
- v Where the CLA refuses to issue a letter of recommendation in accordance with the procedure laid down in the Regulations, the aggrieved party may approach SEBI, which may, if satisfied, direct the CLA to issue a letter of recommendation.
- vi If the exchange refuses listing to the body corporate, mutual fund or collective investment scheme, it may prefer an appeal to the Securities Appellate Tribunal as provided in the Securities Contracts (Regulation) Act, 1956.

***c. SEBI (Portfolio Managers) (Amendment) Regulations, 2002***

SEBI (Portfolio Managers) Amendment Regulations 2002 were notified on 11.10.2002 to amend SEBI (Portfolio Managers) Regulations, 1993 to provide inter-alia the following:

- i The Portfolio Manager to be a Body Corporate.
- ii Multiple registration i.e. registration to associates/group companies/ companies under same management of the Portfolio Manager may be considered. The application may be rejected if any application of a person directly or

- indirectly connected with applicant has been rejected or any disciplinary action has been taken by the Board against such person.
- iii Requirement of minimum two key personnel.
  - iv Before taking up an assignment of management of funds and portfolio of securities, the portfolio manager shall enter into an agreement in writing with the client clearly defining the inter se relationship and setting out their mutual rights, liabilities and obligations relating to the management of funds or portfolio of securities.
  - v The details to be contained in the agreement are specified in Schedule IV. Such agreement between the portfolio manager and the client shall, inter alia, contain:
    - the investment objectives and the services to be provided;
    - areas of investment and restrictions, if any, imposed by the client; type of instruments and proportion of exposure;
    - tenure of portfolio investments; terms for early withdrawal of funds or securities by the clients; period of the contract and provision of early termination, if any
    - attendant risks involved in the management of the portfolio;
    - amount to be invested subject to the restrictions provided under the regulations;
    - fees payable to the portfolio manager; the quantum and manner of fees payable by the client for each activity for which service is rendered by the portfolio manager directly or indirectly (where such service is out sourced) ;
    - in case of a discretionary portfolio manager a condition that the liability of a client shall not exceed his investment with the portfolio manager;
  - vi The portfolio manager shall provide to the client, the Disclosure Document alongwith a certificate regarding the correctness of the contents, atleast two days prior to entering into an agreement with the client. The contents of the Disclosure Document have been specified in Schedule.
  - vii The Disclosure Document, shall inter alia contain the complete disclosures in respect of transactions with related parties as per the accounting standards specified by the Institute of Chartered Accountants of India in this regard; the performance of the portfolio manager; the audited financial statements of the portfolio manager for the immediately preceding three years.
  - viii The contents of the Disclosure Document shall be certified by an independent chartered accountant.
  - ix Disclosure Document to filed with SEBI before its issue and thereafter every six months or effecting material change in Document whichever is earlier.
  - x The portfolio manager shall charge an agreed fee from the clients for rendering portfolio management services without guaranteeing or assuring, any return and the fee so charged may be a fixed fee or a



return based fee or a combination of both.

- xi The portfolio manager shall not accept from the client, funds or securities worth less than five lacs rupees.
- xii The portfolio manager shall not borrow funds or securities on behalf of the client. The portfolio manager shall not lend securities held on behalf of clients to a third person except as provided under these regulations.
- xiii The money or securities accepted by the portfolio manager shall not be invested or managed by the portfolio manager except in terms of the agreement between the portfolio manager and the client.
- xiv The funds or securities can be withdrawn or taken back by the client before the maturity of the contract under the circumstances specified in the regulations.
- xv Permit Portfolio Managers to invest in Derivatives. However, leveraging of portfolio shall not be permitted in respect of investment in derivatives.
- xvi The portfolio manager may, subject to authorisation by the client in writing, participate in securities lending.
- xvii The portfolio accounts of the portfolio manager shall be audited annually by an independent chartered accountant and a copy of the certificate issued by the chartered accountant shall be given to the client.
- xviii The client may appoint a chartered accountant to audit the books and

accounts of the portfolio manager relating to his transactions.

**d. SEBI (Underwriters) (Amendment) Regulations, 2002** were notified on December 10, 2002 vide S.O. No. 1291(E). The amendment provides that an applicant being a merchant banker and seeking registration as underwriter would not be entitled to exemption from payment of the registration fees.

**e. SEBI (Prohibition of Insider Trading) (Second Amendment) Regulations, 2002** were notified on 29th November, 2002 vide S.O. No. 1245(E).

- i The definition of 'person deemed to be a connected person' includes concerns, firms, companies etc. in which other specified insiders have more than 10per cent of the holding or interest. The reference to holdings of relatives of such persons has been removed.
- ii Any communication made in the ordinary course of profession or employment shall also be exempt from the prohibition of regulation 3(ii) in addition to those made in the ordinary course of business or under any law.
- iii A new regulation 3B has been introduced to lay down certain defences in proceedings for violation of regulation 3A in specified circumstances. Sub-regulation (1) says that a company would not be liable under regulation 3A for entering into a transaction in securities while its officer or employee was in possession of unpublished price sensitive information relating to the securities, if the decision to deal was taken by a person other than that officer or



employee, and there are systems and procedures in the company which ensure that such person cannot have access to such information or to advice regarding the transaction from that officer or employee and if the information or advice was in fact not communicated to such person. Sub-regulation (2) of regulation 3B gives exemption in case of an acquisition made in accordance with the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

- iv The continuous disclosure requirements in regulation 13(4) have now been made applicable only in a case where the change in holdings exceeds the lower of Rs. 5 lacs in value, or 25000 shares or 1per cent of the total shareholding or voting rights.
- v The definition of 'designated employee' for the purpose of the Model Code of Conduct for Listed Companies does not now extend to all the employees of the finance department. Only employees who are in the top three tiers of management and those specifically designated by the company would be covered.
- vi It has been clarified that the time of commencement of closure of the trading window in connection with certain specified events shall be decided by the company.

**f. SEBI (Foreign Institutional Investors) (Amendment) Regulations, 2002** were notified in the Official Gazette on December 10, 2002 vide S.O. No. 1292(E). The amendment proposes to further rationalize the registration process of Foreign Institutional Investors.

- i It is required that a certified copy of the relevant clauses or articles of the Memorandum and Articles of Association of the applicant or the agreement authorizing the applicant to invest on behalf of its clients is enclosed alongwith the application form.
- ii The requirement of filing the audited financial statement and annual report pertaining to the last five years is dispensed with. The copies of these documents for the last one year, not being less than 12 months are required to be filed with the application.
- iii The requirement of filing the documents evidencing the registration of the applicant with a Securities Commission or self regulatory organization or any other regulatory authority removed. It would be now sufficient if a declaration is made by the applicant with the requisite particulars.
- iv Instead of filing a copy of the agreement with the domestic custodian, it would suffice, if a declaration is made by the applicant that it has entered into a custodian agreement together with details of the domestic custodian.
- v The registration fee has been reduced from US \$ 10,000/- to US \$ 5,000/-.

**g. SEBI (Mutual Funds) (Second Amendment) Regulations, 2002** The asset management company shall provide an option to the unitholder(s) to nominate a person in whom the units held by the unitholder(s) can be vested in the event of the death of the unitholder(s). The format for nomination has also been specified in the Regulations.

***h. SEBI (Mutual Funds) (Third Amendment) Regulations, 2002*** notified in July, 2002 vide S.O. No.809(E)

- i The variation in NAV has been reduced from '2 percent' to '1percent'.
- ii The Regulations also require that in case the NAV of a scheme differs due to non-recording of transactions by more than 1per cent, the investors or schemes shall be compensated.
- iii If investors are allotted units at higher NAV or they are given lower NAV at the time of their sale of units, they should be compensated by the schemes. However, if investors are charged lower NAV at the time of their purchase of units or they are given higher NAV at the time of their sale of units, asset management company shall compensate the schemes.
- iv It has been provided that the meeting of the Trustees shall be held atleast once in every two calendar months and at least six such meetings to be held in every calendar year.

***i. SEBI (Mutual Funds) (Fourth Amendment) Regulations, 2002*** were notified in September, 2002 Vide S.O. No.956(E) to provide for:

- i Service fees linked to the assets under management as on 31st March of the previous year.
- ii The service fees of Rupees two lakhs fifty thousand payable by all mutual fund to the service fees payable based on the net assets of the fund as on 31st March of the previous year has been modified.

The Regulations provide for scale of service fees payable from Rs.2.50 Lacs to Rs.7.50 Lacs based on the NAV as on 31st March of the previous year.

***j. SEBI (Credit Rating Agencies) (Amendment) Regulations, 2003*** were notified on 19.02.03 Vide S.O. No.203(E). The following amendments were made:

- i The proviso to Regulation 27 provides that Credit Rating Agency may rate a security issued by its associate having a common independent director with it or its rating committee.
- ii The above relaxation is provided subject to condition that the independent director does not participate in the discussions on rating decisions and that the Credit Rating Agency makes a disclosure in the rating announcement of the associate about the existence of the independent director and about his non participation in the rating decisions.
- iii The expression "independent director" has been explained to be as a director who, apart from receiving director's remuneration does not have any material pecuniary relationship or transaction with a company, its promoters, its management or its subsidiaries, which in the judgement of the Board of the company may affect the independence of the judgement of such director.

**VIII. Retrospect and Prospects**

- a) *Retrospect* : The year that went by had now posed several challenges to SEBI.

On one hand there was the challenge of restoring investor confidence which was battered by the market turbulence, while on the other hand the challenge of continuously reviewing, improving and developing the regulatory framework to provide for a market which is fair and transparent as functions with a high degree of efficiency and integrity. In the midst of these challenges, SEBI for the first time forged for itself a vision –“the most dynamic and respected regulator - globally”, and carefully crafted out a strategic action plan, in consonance with SEBI’s objective and its mission to help the securities market retain the competitive edge and to address the structural, systemic and operational risks of the markets. It goes to the credit of the team of SEBI that it was able to successfully complete a large number of the activities. The remaining activities are of continuing nature and SEBI would have to work at these continuously. The major milestones covered by SEBI during the year have already been delineated earlier in this chapter.

b) *Prospects* : In furtherance of its vision and mission, the team of SEBI laid out its Second Strategic Action Plan for the year ahead. If the current year’s (2002-03) plan aimed at building the competitive edge for the Indian Securities Market, the aim of the next year’s plan is to make Indian Securities Market, a global benchmark. SEBI would work assiduously in conjunction with the government , other regulatory agencies and market participants to reach the goal and to make Indian Securities Market , a vibrant and a destination for global capital. Some of the salient features of the Strategic Action Plan for 2003-04 are given below :-

- Development of SROs in various segments of the Market.
- Greater co-ordination with the other regulators with global view of the issue and deliver the better values to the market.
- Enhanced cooperation with overseas regulators for superior regulation and to improve the visibility of the Indian Securities Market at the global level.
- Disclosures for private placements of debt(listed).
- Disclosure norms for debt issues by International Multilateral Agencies.
- Comprehensive Review of Market intelligence and Surveillance Systems
- Concrete measures to enhance liquidity in market
- Disclosures by Market Participants.
- Certification for various intermediaries in the Securities Market to bring in the higher level of professionalism.
- Enhance speed of enforcement actions.
- Physical settlement of the derivative products.
- Cross margining between the cash and derivatives markets to economize the use of capital of the participants in the market.
- Introduction of new financial instruments like fund of funds and real estate funds.
- Policy formulation for the Indian Depository Receipts (IDRs)
- Expansion of STP across the market participants to enhance the processing speed through the seamless flow of information.