PART I

POLICIES AND PROGRAMMES

This Annual Report of the Securities and Exchange Board of India (SEBI) reviews the policies and programmes of the SEBI, its working and operations in the financial year, 1998-99. The Report gives the account of operations and the manner in which the SEBI has been discharging its functions and exercising its 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 gives details of developments in Indian securities markets 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.

During 1998-99, the SEBI continued its operations and initiatives in regulating and promoting the development of Indian securities markets in fulfillment of the twin objectives of investor protection and market development mandated by the SEBI Act, 1992. Throughout its seven-year existence as a statutory body, the SEBI has sought to balance these two objectives by constantly reviewing and reappraising its existing policies and programmes, formulating new policies and crafting new regulations to nurture areas hitherto unregulated and to implement them to ensure growth of the markets with efficiency, integrity and protection of investors' interest. The major reforms and developments in the securities markets during 1998-99 are given in Box I.1

Box 1.1: Major Policy Reforms and Developments in the Securities Markets During 1998-99

Dematerialisation of Securities

- To eliminate the risks associated with trading in physical securities such as delay in transfer, bad delivery, theft, fake and forged shares, several new, and far reaching initiatives were taken by the SEBI to accelerate dematerialisation and electronic book entry transfer of securities -

- Compulsory trading in dematerialised form introduced for the first time for all investors in a phased manner in shares of selected companies which are most actively traded
- the list of companies whose shares are to be compulsorily traded in dematerialised form by institutional investors expanded to cover almost all the actively traded shares accounting for more than 90 per cent of the trading volume
- the Central Depository Services Ltd., a new depository promoted by the BSE and a few commercial banks granted certificate of commencement of business
- the market lots abolished for shares of companies compulsorily traded in dematerialised form by all investors
- the facility of selling small quantities of shares in the physical form of either 500 in number or Rs.25000 in value being introduced in the stock exchanges, to help investors having small holdings to dispose off their holdings easily.

Derivatives Trading

- To provide the facility of hedging and enhance the liquidity in the market, the committee appointed by the SEBI on derivatives recommended phased introduction of trading in derivative products beginning with trading in stock index futures, accepted by the SEBI. The introduction of derivatives is awaiting the amendment of SCR Act.

- The recommendations of the J.R. Verma Committee for risk containment measures for derivative trading including margin system accepted by the SEBI.

Buy-back of Securities

- To help increase the liquidity in the securities and to enable companies to enhance the wealth of shareholders, the facility of buy-back of securities by listed companies introduced for the first time.

Par Value of Shares

- To give the flexibility to the companies to issue shares at any amount and to extend free pricing to its logical conclusion and to benefit the investors, the current requirement for issuing shares with a fixed par value of Rs.10 or Rs.100 abolished for companies whose shares are dematerialised.

Employees Stock Option Scheme

- To provide incentives to employees, the J.R. Verma Committee was constituted by the SEBI to formulate the Guidelines for Employee Stock Options and Employee Stock Purchase Scheme. The Board has considered and accepted the recommendations of the Committee and the Guidelines are being issued.

Facilitating the Development of Infrastructure

- To facilitate increased raising of funds by infrastructure companies, the SEBI granted several relaxations and exemptions from the existing requirements. These are given below:

- Exemption from fulfilling eligibility norms
- Exemption from meeting profitability norms for free pricing of issues –subject to fulfillment of certain conditions.

- Exemption from the requirement of offering at least 25 per cent of securities to public
- Exemption from the requirement of the minimum number of 5 shareholders for every Rs.1 lakh of capital issued.

- Exemption from the requirement of minimum subscription of 90 per cent of public offer
- Relaxation from requirement of minimum financial participation by appraising agency – a minimum participation of 5 per cent of the project cost can be made either jointly or severally by the specified institutions, irrespective whether they have appraised the project or not.

Continuing Disclosures

- To improve the continuing disclosure standards for companies for quicker dissemination of information to investors, quarterly disclosure of financial results by listed companies made mandatory for the first time by the SEBI through the amendment of the listing agreement, thus taking India to the select list of countries with similar continuing disclosure requirement.

- Continuing disclosures further enhanced by the introduction of the requirement of immediate disclosure of any material event in a company having a bearing on the performance of the company and price sensitive information.

Credit Rating Agencies

- To strengthen the credibility of the ratings of credit rating agencies and enhance the transparency in their reporting and information system, the recommendations of the SEBI appointed Committee accepted.

Collective Investment Schemes

- To protect the interest of investors in Collective Investment Schemes and in accordance with the mandate given by the Government, the SEBI initiated the process of framing the regulations for collective investment schemes. To protect the interest of the investors, in the interim period, the SEBI took several measures with a two pronged approach to discipline and take action against erring entities and at the same time to educate the investors about the risks associated with investing in unregulated schemes. The action taken by the SEBI included issuing show cause notices to defaulting entities, initiating court proceedings to obtain appropriate relief in the interest of the investors, conducting a special audit of the books of accounts of the larger entities, making credit rating mandatory for existing schemes, disseminating information to the investors through the issue of press

releases/public notices etc.

Relaxation of Norms for IPOs

- To help lower issue cost and time for making public issues and also to simplify procedures, the ceiling of issue size of Rs.100 crore for book-building reduced to Rs.25 crore.
- To bring down the cost involved in public issues, the SEBI modified the requirement of mandatory collection centres. The minimum number of collection centres for an issue of capital shall be – (a) the four metropolitan centres and (b) such centres where the stock exchanges are located in the region in which the registered office of the company is situated.
- To encourage the mobilisation of capital by new companies, the entry norms for IPOs further relaxed by substituting the requirement of actual payment of dividend in three out of five preceding years, with the ability to pay dividend as demonstrated by distributable profits in accordance with the provisions of the Companies Act in at least three out of five preceding years.
- To improve the liquidity and to encourage entrepreneurs to raise capital through public issues, the requirement of the lock-in period of promoters' contribution in full reduced to only 20% of the total capital of the company.
- To help investors make informed investment decisions, credit rating by approved credit rating agencies made mandatory for all public and rights issues of debt instruments irrespective of their maturity or conversion period as against exemption granted for 18 months.
- To facilitate floatation of issues by public and private sector banks, relaxation made in the Disclosure and Investor Protection guidelines of SEBI for the issue of capital, subject to the approval of the issue price by the RBI, as banks are under the regulatory purview of RBI.

Secondary Market Transparency

- To enhance the transparency in the secondary market, automated screen based trading which was introduced in 20 stock exchanges extended to the remaining 3 more stock exchanges to achieve 100 per cent coverage of automated trading.
- To enhance transparency of negotiated deals, stock exchanges directed to ensure that all negotiated deals result in delivery and deals of value of Rs.25 lakh or volume of 10,000 shares are reported on the screens within 15 minutes of transaction and disseminated to the market.
- To increase the competitiveness in the market and prevent market abuse, the facility of "all or one" available in the trading system of the stock exchanges was abolished.

Increase in Market Access

- To increase market access for investors across the country, the Stock Exchange Mumbai and the National Stock Exchange (NSE) further expanded their terminals through VSAT to cover more than 250 cities and towns.
- To increase the access of Indian securities market to NRIs, OCBs and FIIs, the Indian stock exchanges permitted to set up their trading terminals overseas subject to regulatory requirements of the host countries.

Mutual Funds

- In order to strengthen the disclosure by mutual funds, standard offer document and abridged offer document introduced .
- Several mutual funds directed by the SEBI to honour their commitment to the investors in assured return schemes thus benefiting millions of investors. By the end of March 31, 1999 the total amount paid to investors was Rs.1350 crore.
- To ensure that the Trustees discharge their responsibilities more effectively, the report of the SEBI-appointed Committee under the chairmanship of Shri P.K. Kaul, former Cabinet Secretary submitted to the SEBI.

Market Safety and Risk Containment Measures

- To ensure that settlements take place without failure and to reduce counter party risk, 10 major and medium stock exchanges have set up trade / settlement guarantee funds

measuring an increase of 6 exchanges with an amount of Rs.1000 crore .

- To protect market integrity especially under conditions of abnormal price movement and to contain extreme volatility, margin system strengthened by the SEBI in consultation with the stock exchanges by introducing additional volatility margin, incremental margin for carry forward transaction and concentration margin coupled with reduction of daily price bands from 10 per cent to 8 per cent and abolition of weekly price bands.

Monitoring, Surveillance and Effective Prevention of Market Manipulation

- To help ensure real time monitoring of price movements and broker positions and to generate real time alerts, 4 major and medium sized stock exchanges implemented the first phase of the Stock Watch System.
- Several enforcement actions taken against intermediaries for various violations of the provisions of SEBI Act and rules and regulations and also for market manipulation and unfair trade practices.

Consolidation of Smaller Stock Exchanges

- To help sustain the activities of smaller stock exchanges, the Inter Connected Stock Exchange of India set up by 14 regional stock exchanges, commenced trading operations in a limited way.

Foreign Institutional Investors

- FIIs permitted to directly participate in the public offers in takeover and buyback offer of companies.
- Procedural simplification introduced for registration and operations of the FIIs and the Sub-accounts.

Takeovers and Substantial Acquisition of Shares

- To further protect the interest of investors in takeovers and to enhance equity, fairness and transparency in takeover transactions, the interim recommendations of the reconstituted Committee under the chairmanship of Justice P.N. Bhagwati, former Chief Justice of India accepted.

- The threshold limit for mandatory public offer increased from 10 per cent to 15 per cent of the voting rights of a company.

- The creeping acquisition limit raised from the earlier level of 2 per cent to 5 per cent of the voting rights and also made applicable to persons holding above 51 per cent of voting rights up to 75 per cent.

The important measures indicated above and also the steps discussed later in the Report have helped the SEBI discharge its statutory responsibility of developing and regulating the market and protecting the investors. Besides, the securities market in India has become more modern in terms of infrastructure, adoption of best international practices and introduction of competition. With the maturity of the regulatory framework and increased market surveillance, the market has become safer and the investor is better protected. While volatility has become an endemic feature of all the markets in the world because of increased volumes within the markets and cross border, complexities, impact of other financial markets like currency, commodities and property, existence of common players in different markets fleeing from one market to the other, thus transmitting the risk, the Indian market has remained comparatively less volatile, see ***Annexure 1***. This has been possible because of the prudential macro-economic policies of the country, proper management of change and effective regulatory system.

While introducing these measures, the SEBI continued to follow an open and transparent policy, and a consultative approach. It also maintained a close interface with the market participants and professionals, and the feedback, as well as expert advice obtained from them have guided the SEBI in framing its

policies and programmes.

In the Annual Report for the year 1997-98, the SEBI had set for itself certain goals in the short and the medium term. The Table 1.1 below measures the performance of the SEBI against these goals.

Table 1.1 Targets and Achievements

Short and medium terms targets set out in the Annual Report of 1997-98	***Achievements***
1. To give impetus to dematerialisation and book entry transfer	As already stated earlier, considerable progress has been made in dematerialisation of shares. The SEBI has taken several steps to facilitate book entry transfer. The Central Depository Services (India) Limited has been registered as second depository.
● To consider shortening of settlement cycles and move towards rolling settlement and DVP on the lines suggested by the Group of Thirty.	SEBI had already reduced 14 day trading and settlement cycles to 7 days. The rolling settlement system has been introduced on a voluntary basis by the SEBI in dematerialised segment.
● To implement the recommendations of the Committee appointed by the SEBI on derivatives and introduce derivative trading on the Stock exchanges.	The regulation of derivatives trading has been approved by the SEBI. It is awaiting the amendment to SCR Act by the Parliament.
● To further strengthen the surveillance mechanisms at the stock exchange level and within the SEBI.	Monitoring and surveillance have been focus area for the SEBI. Surveillance cells have been set up in stock exchanges and a surveillance division is operating in the SEBI. Most of the major stock exchanges have implemented Phase I Stock Watch on-line surveillance system, as already indicated extensive actions have been taken against regulatory violations and against price manipulation and unfair trade practices.
● To take measures to further streamline and shorten issue procedures with a view to reducing the cost of issues.	The SEBI has taken several measures such as revised book building system, refined entry points norms, relaxation of entry norms for infrastructure companies, reduction in the mandatory collection centres etc. to streamline and shorten issue procedures and to reduce the cost and time taken of issues.
● To take follow up action on the recommendations of the Justice Dhanuka Committee on securities laws	The SEBI Board broadly agreed with the thrust of the recommendations of the Dhanuka committee which are presently under the consideration of the Government of India.
● To prescribe regulation on collective investment schemes	The SEBI has issued interim directions to collective investment schemes. The SEBI directed the entities not to collect any monies under the existing schemes unless the

	instruments of collective investment schemes have been rated by a credit rating agency. The interim report of the Dave Committee was received by the SEBI and the final report has been received on April 5, 1999.
● To prescribe regulations for credit rating agencies.	The SEBI appointed a committee for framing regulations for credit rating agencies. The regulations have been accepted by the Board.
● To further refine the takeover regulations in the line of experience on takeovers during the year under review.	The SEBI reconstituted Bhagwati Committee to consider the provisions of the SEBI (Substantial Acquisitions of Shares and Takeovers) Regulation, 1997. Following the recommendations of the committee, many relaxations have been extended by the SEBI in respect of threshold limits etc. The final report is expected shortly.
● To facilitate market making system.	The SEBI has appointed a committee on market making. The committee has completed its deliberations, and the report will be submitted shortly. In the meantime, in one exchange the market making system has been introduced.
● To take measures to implement the recommendations of Chandrasekaran Committee on the issues relating to transfer and registration of securities.	The listing agreement was amended to provide for appointment of compliance officers to monitor share transfer and registration of securities.
● To take steps to review the OTCEI by making changes wherever necessary in the systems, procedures and policies of OTCEI.	The recommendations of Dave Committee implemented except introduction of trading in unlisted securities. The Board of OTCEI formulated a new revival package.
● To strengthen further the regulations for mutual funds so as to ensure their continued growth and enhance the level of investor protection.	Several meetings were held with the Association of Mutual Funds, to discuss regulatory and operational issues. The SEBI introduced Standard Offer Document system for filing scheme details on mandatory basis in order to strengthen disclosure standards for protection of investors.
● To take follow-up action on the recommendations of P.K. Kaul Committee regarding the manner in which trustees of mutual funds could function effectively.	The SEBI held meetings with trustees of mutual funds to get the feed back from them on the recommendations of P.K. Kaul committee relating to responsibilities of the trustees. The report is awaiting the approval of the SEBI Board.
● To give impetus to stock lending for which guidelines have been issued by the SEBI but the activity is yet to pick up.	The SEBI has given approval to 4 entities to act as approved intermediaries under stock lending scheme and one of them is National Securities Clearing Corporation Ltd.(NSCCL) which has introduced Automated Lending and Borrowing Mechanism (ALBM).
● To activate trading in bonds and debentures and take all necessary measures including coordination with relevant agencies for this purpose.	In the Annual Budget (1999-2000), certain fiscal concessions were announced relating to stamp duties etc.,. The measures are being initiated to activate trading in bonds and debentures. The subject is under consideration of SEBI.

Source: SEBI

The SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 was amended on 16th December, 1998, the SEBI (Foreign Institutional Investors) Regulations, 1995 were amended on 20th April, 1998, 18th May, 1998, 30th June, 1998 and SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 was amended on 28th October, 1998. Pursuant to the amendment in the Companies Act, SEBI made regulations for buy-back of securities for listed company which was notified on14th November, 1998.