PART ONE: POLICIES AND PROGRAMMES

The Annual Report of the Securities and Exchange Board of India (SEBI) for 2005-06 articulates the policies and programmes of SEBI and its working and operations during the financial year as per format prescribed by the Securities and Exchange Board of India (Annual Report) Rules, 1994. SEBI continued to pursue its endeavour to achieve the three statutory objectives, namely: a) protection of the interests of investors in securities; b) development of the securities market; and c) regulation of the securities market. Keeping in view the mandated objectives, the Report delineates the manner in which SEBI discharged its responsibilities and exercised its power during the year in terms of: a) the Securities and Exchange Board of India Act, 1992; b) the Securities Contracts (Regulation) Act, 1956; c) the Depositories Act, 1996; and d) the delegated powers under the Companies Act, 1956. The Report also provides an analytical review of the developments in the Indian securities market during 2005-06 in the context of the evolving regulatory framework provided by SEBI. Notwithstanding increasing integration of the financial markets, both domestic and cross-border, and growing sophistication of the Indian capital market, SEBI channelised its efforts to strike a balance between competing objectives. Efforts were made to strengthen the regulatory framework by reviewing its policies and programmes, initiating new guidelines and regulations and nurturing a security culture in India for the orderly growth of capital market in general and ensuring transparency, efficiency, fairness, safety and integrity of the capital market in particular. The major policy initiatives and developments in the securities market during 2005-06 are presented below (Box 1.1).

Box 1.1: Major Policy Initiatives and Developments in the Capital Market during 2005-06

I. Primary Securities Market

Specific Allocation for Mutual Funds

- Within the category of Qualified Institutional Buyers (QIBs), there was no specific allocation for any group in case of book built issues. In order to increase the retail participation through mutual funds, SEBI introduced a specific allocation of 5 per cent within the QIB category with effect from September 19, 2005. The mutual funds are also eligible for allotment from the balance available for the QIB category.

Proportionate Allotment to QIBs

- In an effort to provide level playing field and also to prevent misuse of discretion exercised by the merchant bankers in the process of allocation of shares, it was decided that the allotment to QIBs shall also be made on a proportional basis.

Margin Requirement for QIBs

- Although, there was no regulatory stipulation as regards the proportion of margin to be collected from the subscribers to a public issue, in practice, 100 per cent margin was collected from the non-institutional investors while the institutional investors did not give any margin. As a move towards level playing field, SEBI introduced a 10 per cent margin on QIB bids.

ECS Facility for Public Issue Refunds

- In order to ensure faster and hassle-free refunds, it was decided to extend the facility of electronic transfer of funds to public issue refunds, initially at 15 centers where clearing houses are managed by RBI.

Box 1.1: Major Policy Initiatives and Developments in the Capital Market during 2005-06

I. Primary Securities Market *(Contd.)*

Minimum Public Shareholding

- In order to maintain uniformity and also for the purpose of continuous listing, it was decided to amend SEBI (DIP) Guidelines, 2000 providing a minimum public shareholding of 25 per cent in case of all listed companies barring a few exceptions.

Introduction of Optional Grading of IPO

- With a view to assisting the investors, particularly the retail investors, SEBI has given in-principle approval for grading of IPOs by the rating agencies at the option of the issuers. SEBI will not certify the assessment made by the rating agencies.

Rationalisation of Disclosure Requirements for the Listed Companies

- Under the Listing Agreement, a listed company is required to make continuous disclosures to the stock exchanges. In order to rationalise the disclosure requirements, it was decided to do away with the repetitive disclosures in case of rights issues and public issues by the listed companies which have a satisfactory track record of filing periodic returns with the stock exchanges and have a comprehensive mechanism for satisfactory redressal of investor grievances.

Abridged Letter of Offer

- In order to bring uniformity in the practice of making available abridged offer documents, it was decided to permit an issuer company making a rights issue, to despatch an abridged letter of offer which shall contain disclosures as required to be given in the case of an abridged prospectus.

Disclosure of Issue Price

- In case of a fixed price issue, a company is required to disclose the issue price or the price band in the offer document filed with SEBI. In order to provide flexibility, it was decided to allow a listed company to fix and disclose the issue price in case of a rights issue any time prior to fixing of the record date in consultation with the designated stock exchange, and in case of public issue through fixed price route, at any time prior to filing of prospectus with the Registrar of Companies.

Further Issue of Shares

- Further issue of capital by a company, after filing a draft offer document with SEBI, was prohibited till the listing of shares that are referred to in the offer document. In order to facilitate additional resource mobilisation, a company has been permitted to issue further shares, provided full disclosures as regards the total capital to be raised from such further issues are made in the draft offer document.

Corporate Governance of Listed Companies

- Under Clause 49 of the Listing Agreement, listed companies were advised to comply with the revised guidelines on corporate governance, including appointment of the independent directors. Initially the compliance date was April 1, 2005, which was subsequently extended to December 31, 2005. Without further extension of the deadline, a few clarifications were given in January 2006 relating to maximum gap between two Board meetings, sitting fees of the non-executive directors and certification on internal control system by the CEO/CFO.

II. Secondary Securities Market

Separate Window for Execution of Block Deals

- In order to facilitate execution of large trades without impacting the market, the stock exchanges were allowed to provide a separate trading window for block deals subject to certain conditions. BSE and NSE activated this window with effect from November 14, 2005.

Review of Dematerialisation Charges

- In order to enable an investor, who is not satisfied with the services of a DP, to shift his Beneficiary Owner (BO) account to another DP, SEBI advised the depositories/DPs not to levy any charges when a BO transfers

Box 1.1: Major Policy Initiatives and Developments in the Capital Market during 2005-06

II. Secondary Securities Market *(Contd.)*

all his securities lying in his account to another branch of the same DP or to another DP of the same depository or another depository, provided the BO accounts at the transferee DP and at transferor DP are one and the same.

Activation of ISINs of Initial Public Offerings (IPOs)

- There is a time gap of about four to five days between the crediting of securities to a Beneficiary Owner's account and the commencement of trading. The time gap was utilised by a few investors to indulge in off-market trades prior to the commencement of trading. In order to prevent such transactions, SEBI advised depositories that, in case of IPOs, the ISINs of securities should be activated only on the date of commencement of trading on the stock exchanges.

SEBI (Central Database of Market Participants) Regulations, 2003

- Following recommendations of the Jagdish Capoor Committee, it was decided to resume registration under the MAPIN regulations in phases and obtain the Unique Identification Number (UIN) with biometric impression for a trade order value of Rs. 5 lakh and above. For trade order of value less than Rs. 5 lakh, a choice is given to the investors (natural persons) to provide either the Permanent Account Number (PAN) of the Income Tax Department or UIN obtained under MAPIN. Pending implementation of the above decision, PAN has been made compulsory for all categories of investors for opening a demat account with effect from April 1, 2006. The existing demat account holders are required to submit details of PAN by September 30, 2006.

Discontinuation of Hand Delivery Bargains/Delivery *versus* Payment

- In order to streamline the settlement system, consistent with IOSCO recommendations, transactions executed on the stock exchanges would be necessarily settled through the clearing corporation/clearing house of the stock exchanges. The earlier practice of Hand Delivery Bargains/Delivery *versus* Payment (DvP) was discontinued with effect from September 19, 2005.

Guidelines for Issuing Electronic Contract Notes

- In order to provide further safeguard to the issuance of contract notes, additional conditions were prescribed such as sending of Electronic Contract Notes (ECNs) to a designated e-mail ID and retention of acknowledgements of receipt/proof of delivery only to such clients who have consented for the same. Wherever the ECNs have not been delivered or have been rejected by the e-mail ID of the client, the broker is obligated to send the physical contract note(s) within the stipulated time under the extant SEBI guidelines.

Shifting of Securities from Trade-for-Trade Segment to Rolling Settlement

- On the basis of information as regards connectivity of companies provided by the depositories, stock exchanges were advised to shift the shares of certain companies from trade-for-trade segment to rolling settlement subject to their having at least 50 per cent of non-promoter holdings in demat mode as per Clause 35 of the Listing Agreement.

Committee to Study the Future of Regional Stock Exchanges

- A Committee was set up under the Chairmanship of Shri G. Anantharaman, Whole Time Member, SEBI to review and examine the future of the Regional Stock Exchanges (RSEs) - post-demutualisation. According to the terms of reference, the Committee has to deliberate and advise on the future role of RSEs, manner of dealing with assets in the event of withdrawal of recognition and the process of divestment of shareholding.

Policy Initiatives for Derivatives

- Based on the recommendations of the Secondary Market Advisory Committee, the trading member position limit for stock based derivatives has been revised.
- Derivatives can be introduced on stocks of large companies undergoing corporate restructuring on the first day of listing subject to certain conditions.

Box 1.1: Major Policy Initiatives and Developments in the Capital Market during 2005-06

II. Secondary Securities Market *(Contd.)*

Corporatisation and Demutualisation (C and D) of Stock Exchanges

- In order to expedite the Corporatisation and Demutualisation of stock exchanges, SEBI approved and notified the C and D schemes of 19 stock exchanges during 2005-06. The NSE and OTCEI have been exempted from submitting the C and D schemes as they were already notified as corporatised and demutualised stock exchanges *vide* notification dated March 23, 2005 and September 15, 2005, respectively.

III. Mutual Funds

Gold Exchange Traded Funds in India

- Pursuant to the announcement made by the Honourable Finance Minister in his Budget Speech for 2005-06, SEBI appointed a Committee for the introduction of Gold Exchange Traded Fund (GETF) in India. Based on the recommendations of the said Committee, the SEBI (Mutual Funds) Regulations, 1996 were amended and notification was issued on January 12, 2006 permitting mutual funds to introduce GETFs in India subject to certain investment restrictions.

Minimum Number of Investors in Scheme(s)/Plan(s) of Mutual Funds

- According to the SEBI Guidelines dated December 12, 2003, every mutual fund scheme should have a minimum of 20 investors and holding of a single investor should not be more than 25 per cent of the corpus. SEBI clarified that this stipulation is applicable at the portfolio level. Moreover, if there is a breach of 25 per cent limit by an investor over the quarter, a rebalancing period of one month would be allowed.

Unique Client Code (UCC) for Mutual Fund Scheme(s)/Plan(s)

- In order to facilitate the unit holders to claim tax benefit associated with the payment of Securities Transaction Tax (STT), it was decided to allow mutual funds to share the unique client code of their schemes/plans with their unit holders.

Investments in ADRs, GDRs and Foreign Securities by Mutual Funds

- Mutual funds were permitted to invest in ADRs, GDRs and foreign securities. In case disclosures to this effect were not made in the offer document, all mutual funds were advised to send a written communication to the investors about the proposed investment.

Review of Time Limit for Updating NAV on AMFI Website

- In view of the difficulties faced by mutual funds, the time limit for uploading the net asset value (NAV) on the AMFI website was extended from 8 p.m. to 9 p.m.

Venture Capital Funds

- The Venture Capital Funds were allowed to invest in securities of foreign companies subject to the conditions stipulated by RBI and SEBI from time to time.

IV. Foreign Institutional Investors (FIIs)

FII Investment in Debt Securities

- The outstanding limit for FII investment in debt securities for 2006-07 has been revised upward by the Government within the overall limit of External Commercial Borrowings (ECBs). While such limit for Government Securities (including Treasury Bills) was raised from US $ 1.75 billion to US $ 2.00 billion, the same for the corporate debt had been increased from US $ 0.5 billion to US $ 1.5 billion. The sub-ceilings continued to remain separate and not fungible.

V. Corporate Restructuring

Takeovers

- In order to provide flexibility to corporate restructuring, SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 is being amended which include, *inter alia*, removal of restrictions on market purchases and preferential allotments. The outgoing shareholders can sell entire stake to the incoming acquirer in case

Box 1.1: Major Policy Initiatives and Developments in the Capital Market during 2005-06

V. Corporate Restructuring *(Contd.)*

of takeover. However, if the target company's minimum public shareholding falls below the prescribed minimum, the restoration should take place through a framework provided by the revised Clause 40A of the Listing Agreement.

Delisting of Securities

❖ In order to simplify the existing framework, the SEBI (Delisting of Securities) Guidelines, 2003 were amended, making it possible for stock exchanges to delist the shares of errant companies which are not complying with the Listing Agreement.

VI. Regulatory Amendments

❖ In order to fine-tune the regulatory requirements, following regulations were amended during 2005-06:
- SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) (Amendment) Regulations, 2005.
- SEBI (Mutual Funds) (Amendment) Regulations, 2006.
- SEBI (Custodian of Securities) (Amendment) Regulations, 2006.
- SEBI (Venture Capital Funds) (Amendment) Regulations, 2006.

1. GENERAL MACRO-ECONOMIC ENVIRONMENT

The performance of the Indian economy was impressive during 2005-06, mainly led by sustained growth in industry and services sectors. According to the advance estimates of the Central Statistical Organisation (CSO), the real GDP at factor cost at 1999-00 prices (New Series) grew by 8.4 per cent in 2005-06 on top of 7.5 per cent (quick estimates) achieved in the previous year (Table 1.1). The industrial sector performed well, mainly propelled by manufacturing activities which recorded a growth of 9.0 per cent in 2005-06 compared to 8.1 per cent in 2004-05 (Table 1.2). The services sector continued to be the main driver of growth in India with double digit growth rate (10.3 per cent) for the second year in succession. Following improvement in the South-West monsoon and above normal North-East monsoon, the agricultural sector recovered significantly with a higher growth rate of 3.9 per cent in 2005-06 as against 0.7 per cent in 2004-05. However, the share of 'agriculture and allied activities' in the overall GDP declined from 20.8 per cent in 2004-05 to 19.9 per cent in 2005-06 (Chart 1.1). In contrast, the share of services sector improved from 59.7 per cent to 60.7 per cent and that of industry sector was maintained at 19.5 per cent during the same period. During the first four years of the Tenth Plan (2002-06), India's real GDP grew at an average rate of about 7.0 per cent compared to 5.5 per cent in the Ninth Plan period (1997-2002). India continued to maintain its pre-eminence as one of the fastest growing economies of the world.

One of the notable developments during 2005-06 has been resurgence of industrial sector led mainly by manufacturing activities. Major factors contributing to acceleration in the manufacturing activities were buoyant exports, increase in domestic demand, rise in capacity utilisation, encouraging outlook on business expectations and congenial investment climate.

Table 1.1: National Income (At 1999-00 prices)

(Rs. crore)

Item	2003-04	2004-05 (Quick Estimates)	2005-06 (Revised Estimates)
1	2	3	4
A. Estimates at Aggregate Level			
1. National Product			
1.1 Gross National Product (GNP) at factor cost	22,08,196	23,76,729 (7.6)	25,71,310 (8.2)
1.2 Net National Product (NNP) at factor cost	19,86,858	21,41,776 (7.8)	23,25,282 (8.6)
2. Domestic Product			
2.1 Gross Domestic Product (GDP) at factor cost	22,26,041	23,93,671 (7.5)	25,95,339 (8.4)
2.2 Net Domestic Product (NDP) at factor cost	20,04,703	21,58,718 (7.7)	23,49,311 (8.8)
B. Estimates at Per Capita Level			
1. Population (million)	1,073	1,090 (1.6)	1,107 (1.6)
2. Per Capita NNP at factor cost (Rs.)	18,517	19,649 (6.1)	21,005 (6.9)

Note: Figures in the parentheses are percentage change over the previous year.

Source: Central Statistical Organisation.

Table 1.2: GDP at Factor Cost by Economic Activity (At 1999-00 prices)

(Rs. crore)

Industry	2003-04	2004-05 (Quick Estimates)	2005-06 (Revised Estimates)	Percentage Change over the Previous Year	
				2004-05	2005-06
1	2	3	4	5	6
1. Agriculture, Forestry & Fishing	4,93,690	4,97,351	5,16,603	0.7	3.9
2. Mining & Quarrying	49,714	52,594	53,090	5.8	0.9
3. Manufacturing	3,33,848	3,60,822	3,93,186	8.1	9.0
4. Electricity, Gas & Water Supply	50,927	53,097	55,888	4.3	5.3
5. Construction	1,38,548	1,55,920	1,74,712	12.5	12.1
6. Trade, Hotels, Transport and Communication	5,51,542	6,10,115	6,80,208	10.6	11.5
7. Financing, Insurance, Real Estate & Business Services	2,93,545	3,20,554	3,51,582	9.2	9.7
8. Community, Social & Personal Services	3,14,227	3,43,218	3,70,072	9.2	7.8
GDP at Factor Cost	**22,26,041**	**23,93,671**	**25,95,339**	**7.5**	**8.4**

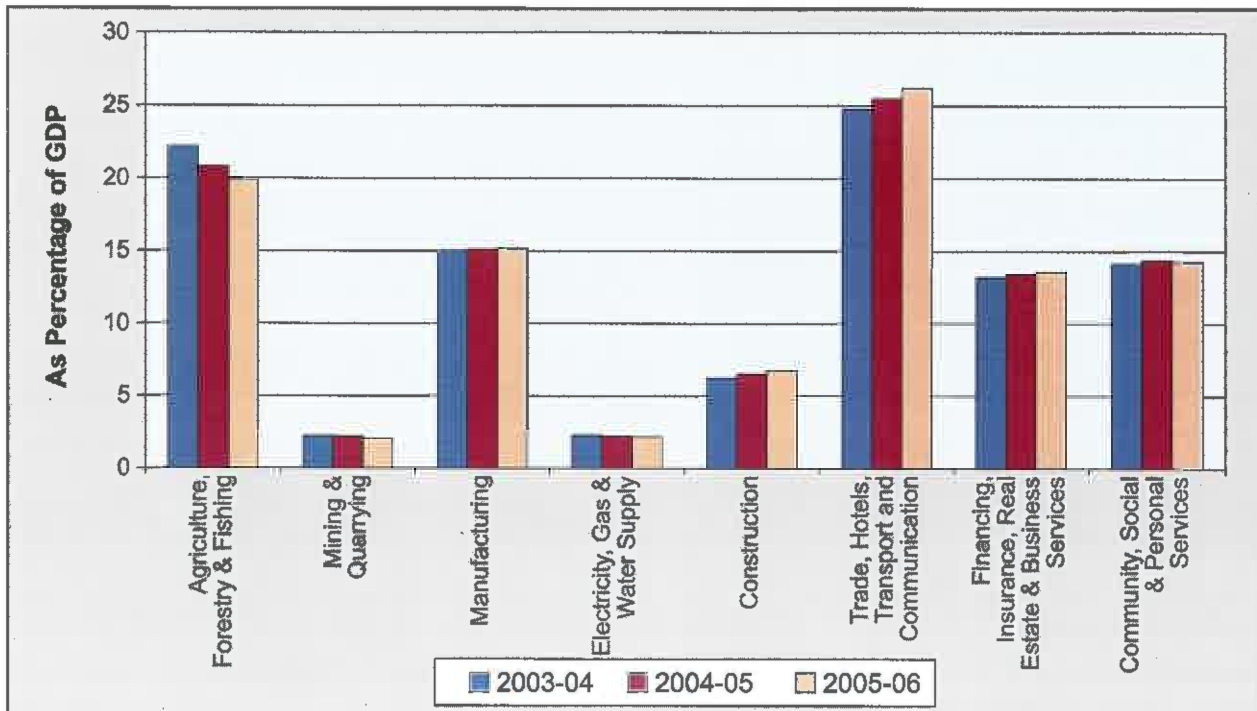
Source: Central Statistical Organisation.

In consonance with an investment boom, capital goods and consumer goods sectors performed extremely well. 'Textile products', 'beverages, tobacco and related products', 'basic metals and alloy industries' and 'transport equipment and parts' witnessed double digit growth in 2005-06. However, growth in the intermediate goods and infrastructure sectors was sluggish. Decline in the production of crude petroleum was largely due to a fire at Mumbai-High oil field. Deceleration in the generation of electricity could be attributed to shortage of coal and gas. According to the business expectation surveys conducted by various agencies, India's industrial sector is likely to continue its strong performance in the near future.

Services sector continued to remain the largest contributor to the overall GDP growth. Within the services sector, 'construction', 'trade, hotel, transport and communication' maintained double digit growth rates in 2005-06. 'Financing, insurance, real estate and business services' grew at an accelerated rate in 2005-06 while there was a deceleration in the growth rate in 'community, social and personal services'. Heightened activities in the services sector could be gauged from an increase in revenue earning freight traffic by the Railways, rise in new mobile phone connections, pick up in cargo handled at major ports, acceleration in the production of cement, steel etc.

Latest data on India's savings and investments are available up to 2004-05. According to the CSO, India's Gross Domestic Saving (GDS) as proportion to GDP at current market prices (New Series) increased from 28.9 per cent in 2003-04 to 29.1 per cent in 2004-05. This could be attributed mainly to higher public sector savings, which rose from 1.0 per cent in 2003-04 to 2.2 per cent in 2004-05, arising out of improvement in the savings of non-departmental enterprises and lower dis-saving of the public authorities. Private corporate sector saving also improved modestly from 4.4 per cent in 2003-04 to 4.8 per cent in 2004-05 reflecting higher corporate profits. However, savings of the household sector declined by 1.5 percentage points to 22.0 per cent in 2004-05. The decline in this ratio was more pronounced in case of financial assets than in physical assets. The

Chart 1.1: Share of Components of GDP at Factor Cost



Gross Domestic Capital Formation (overall investment), which was lower than GDS during the previous three years, exceeded GDS by one percentage point and was 30.1 per cent of GDP in 2004-05 reflecting net inflow of foreign savings. High rate of investment augurs well for sustaining the high rate of GDP growth and for improving productivity.

Among its components, 'deposits' continued to dominate gross financial savings of households. However, its share in total financial savings declined from 41.5 per cent in 2003-04 to 38.3 per cent in 2004-05 (Chart 1.2). On the contrary, the share of 'claims on Government' rose significantly from 20.2 per cent in 2003-04 to 23.3 per cent in 2004-05. This shift in the pattern of household financial

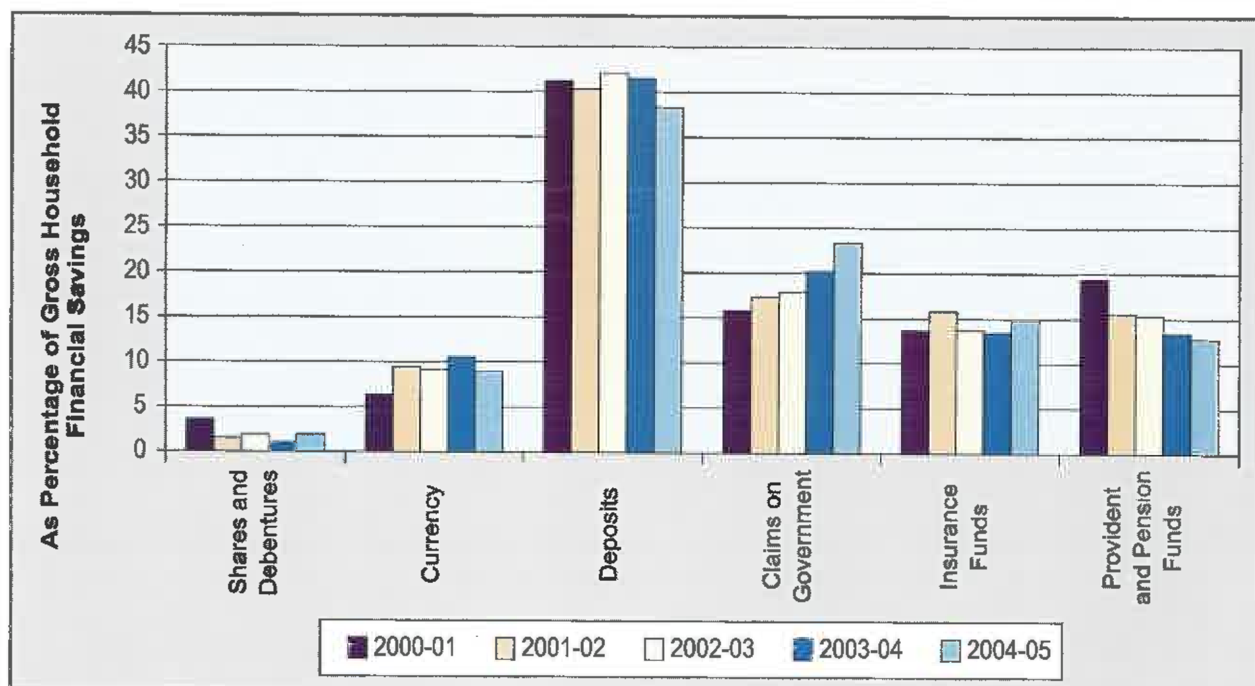
Table 1.3: Gross Domestic Saving and Investment

Item	Amount in Rupees crore				Per cent of GDP at current market prices			
	2001-02	2002-03	2003-04@	2004-05*	2001-02	2002-03	2003-04@	2004-05*
1	2	3	4	5	6	7	8	9
1. Household Sector Saving	5,02,674	5,65,408	6,48,634	6,87,079	22.03	23.08	23.50	22.01
a) Financial Assets	2,47,476	2,53,256	3,16,444	3,20,777	10.85	10.34	11.46	10.28
b) Physical Assets	2,55,198	3,12,152	3,32,190	3,66,302	11.19	12.74	12.03	11.74
2. Private Corporate Sector Saving	81,669	99,767	1,20,852	1,50,947	3.58	4.07	4.38	4.84
3. Public Sector Saving	-46,377	-16,181	28,026	69,390	-2.03	-0.66	1.02	2.22
4. Gross Domestic Saving (GDS)	5,37,966	6,48,994	7,97,512	9,07,416	23.58	26.49	28.89	29.07
5. Net Capital Inflow (+)/ Outflow (-)	-14,229	-28,486	-45,380	32,139	-0.62	-1.16	-1.64	1.03
6. Gross Domestic Capital Formation (GDCF)	5,23,737	6,20,508	7,52,132	9,39,555	22.96	25.33	27.25	30.10
7. Final Consumption Expenditure	17,47,672	18,27,790	20,26,042	22,42,647	76.61	74.61	73.40	71.85
a) Private Final Consumption Expenditure	14,67,315	15,38,928	17,18,227	18,91,087	64.32	62.82	62.25	60.58
b) Government Final Consumption Expenditure	2,80,357	2,88,862	3,07,815	3,51,560	12.29	11.79	11.15	11.26
Memo Items								
Saving-Investment Balance (4-6)	14,229	28,486	45,380	-32,139	0.62	1.16	1.64	-1.03
Public Sector Balance#	-2,03,957	-1,67,427	-1,52,202	-1,55,929	-8.94	-6.83	-5.51	-5.00
Private Sector Balance#	2,01,642	2,11,364	2,48,568	2,14,246	8.84	8.63	9.01	6.86
a) Private Corporate Sector	-45,834	-41,892	-67,876	-1,06,531	-2.01	-1.71	-2.46	-3.41
b) Household Sector	2,47,476	2,53,256	3,16,444	3,20,777	10.85	10.34	11.46	10.28
Investment in Shares and Debentures	4,475	5,929	3,968	8,197	0.20	0.24	0.14	0.26

@ : Provisional Estimates. * : Quick Estimates. # : Investment figures are not adjusted for errors and omissions.

Source: Central Statistical Organisation.

Chart 1.2: Share of Types of Savings in Financial Savings of the Household Sector



savings from deposits to claims on Government may have been driven by the relatively higher returns available from various small saving instruments. During 2004-05, the other major components of financial savings were contractual savings, mainly insurance (14.8 per cent), followed by provident and pension funds (12.7 per cent) and currency (8.9 per cent). Investment in shares and debentures by the households as a proportion to the total financial savings (gross) increased from 1.0 per cent in 2003-04 to 1.9 per cent in 2004-05; and as a proportion of GDP, from 0.14 per cent to 0.26 per cent during the same period.

Lending activities by commercial banks further accelerated during 2005-06. For the second year in succession, non-food credit witnessed a robust expansion reflecting a pick-up in GDP growth in general and industrial activities in particular. Credit to services sector, including retail lending, particularly to the housing sector, also accelerated during 2005-06. In consonance with the high GDP growth, credit expansion was substantial to sectors like food processing, iron and steel, cotton textiles, and construction. During 2005-06, credit growth outpaced deposit growth by a wide margin. However, liquidity condition remained comfortable during the greater part of the year with inflow of capital, particularly portfolio investment by FIIs. To accommodate the growing demand for credit, commercial banks also liquidated Government securities held in excess of SLR requirement to a significant extent.

Amidst a strong rally in the stock prices, financial markets remained, by and large, stable during the year under review. However, following robust credit demand and inadequate deposit growth, there was some pressure on interest rates, particularly at the short-end of the market. The yield curve got flattened with a hesitant rise in long-term interest rates. Corporates restructured their debt profile and also resorted to external commercial borrowing. Moreover, they mobilised sizeable amount of resources through the issue of ADRs and GDRs, and by accessing the domestic markets through large number of public and rights issues and private placements.

Price situation was benign during the greater part of 2005-06. On a point to point basis, the inflation rate, measured by variation in the Wholesale Price Index (WPI), was 4.0 per cent at the end of March 2006 compared to 5.1 per cent a year ago. On an average basis, the inflation rate was 4.5 per cent in 2005-06 compared to 6.4 per cent in the previous year. Prices of manufactured products (weight: 63.8 per cent in WPI) rose by only 1.5 per cent by the end of March 2006 as against 4.6 per cent a year ago. Despite record increase in the international prices of crude oil, fuel group recorded a rise of 8.9 per cent in 2005-06 which was lower than that of 10.5 per cent in the previous year. As a part of deliberate policy, the Union Government has not passed on the entire burden of rise in international crude oil prices to the consumers. The sustained high international prices of crude oil continued to remain a major concern for oil importing countries including India.

Reflecting the surge in crude oil prices, India's oil import bill increased significantly during 2005-06. With high growth and buoyancy in industrial activities, non-oil imports also rose substantially. Thus, in spite of a high growth in exports, the trade deficit widened significantly during 2005-06. Although bulk of the trade deficit was financed through net receipts under invisibles, particularly through remittances from the Indian migrant workers abroad and earnings from exports of IT-enabled services, the external current account deficit is estimated to be higher in 2005-06 than in the previous year. Capital flows more than offset the current account deficit and contributed to the accumulation of foreign exchange reserves by RBI. Despite the single largest outflow of US $ 7.1 billion on account of the redemption of India Millennium Deposit (IMD), India's foreign exchange reserves rose by US $ 10.1 billion during 2005-06, roughly equal to the net portfolio investment in equity by the FIIs. Although the exchange rate exhibited two way movements, it was more or less stable during the year except some pressure following the repayment of IMD in December 2005.

2. REVIEW OF POLICIES AND PROGRAMMES

SEBI initiated a number of policies and programmes during 2005-06 in consultation with the Government of India. These policies and programmes are presented in this Section under six major heads *viz.* primary securities market, secondary securities market, mutual funds, foreign institutional investors, corporate restructuring, and investor awareness/ education/protection. The Section is concluded with 'retrospect and prospects'.

I. Primary Securities Market

A developed primary market is essential for providing a base to a vibrant secondary market. Indian primary market, which gathered momentum in 2004-05, strengthened further in 2005-06 with ongoing process of reforms in the primary market, improving the confidence of the investors as well as the issuers in the market. A large number of small companies entered the primary market for resource mobilisation. Response of the various categories of investors to the public issues was highly encouraging. A detailed analysis on the number of issues, amount mobilised, size and composition of issues and industry-wise resource mobilisation is given in Part Two of this report. Major policy initiatives taken by SEBI during 2005-06 relating to the primary market are presented below:

a. Specific Allocation for Mutual Funds

In case of book-built issues, the Qualified Institutional Buyers (QIBs) such as banks, mutual funds, FIIs etc., are entitled to an

allocation of 50 per cent except mandatory allocation of 60 per cent in terms of Rule 19(2) (b) of SC(R) Rules, 1957. Within the category of QIBs, there was no specific allocation for any group. In order to increase retail participation, SEBI (DIP) Guidelines, 2000 were amended to introduce a specific allocation of 5 per cent to mutual funds within the QIB category with effect from September 19, 2005. In addition, mutual funds would also be eligible for allotment from the balance available for the QIB category.

b. Proportionate Allotment to QIBs

Earlier, in case of book-built issues, the allotment to non-institutional investors was made on a proportionate basis while the allocation to QIBs (institutional investors) was discretionary. In an effort to provide a level playing field and also to prevent the misuse of discretionary power by merchant bankers, the allotment of shares to QIBs was mandated to be made on a proportionate basis.

c. Margin Requirement for QIBs

According to the existing guidelines, there was no regulatory stipulation regarding margins to be collected from the subscribers to the public issues. However, in practice, 100 per cent margin was collected from the retail and non-institutional investors, whereas no margin was collected from the QIBs. As a move towards providing a level playing field, SEBI stipulated collection of 10 per cent margin on QIB bids.

d. ECS Facility for Public Issue Refunds

Refunds in public issues were being sent through post/registered post, which have time and cost implications for investors. In order to ensure faster and hassle-free refunds, it was decided to extend the facility of electronic transfer of funds to public issue refunds. To begin with, applicants residing at 15 centers, where clearing houses are managed by RBI, will get refund through Electronic Clearing Services (ECS) except where applicant has otherwise disclosed as eligible to get refunds through direct credit or RTGS. The details of bank accounts of the applicants shall be taken directly from the depository's database for issues that are required to be made wholly in dematerialised form. SEBI advised all merchant bankers to ensure that suitable instructions for refunds through various modes are incorporated in the application form, abridged prospectus etc., in an appropriate manner as required by the guidelines.

e. Minimum Public Shareholding

Llisted companies are required to maintain their public shareholding at a level that was required at the time of initial listing. The minimum public shareholding requirement, therefore, varied in accordance with the provisions applicable at the time of initial listing of the company. It was decided to revise the above provisions relating to the minimum public shareholding, which are as follows:

- All listed companies will be required to maintain at least 25 per cent shareholding with the public for the purpose of continuous listing;
- This will not, however, be applicable to companies which are permitted to make an IPO of at least 10 per cent to public in terms of Rule 19(2)(b) of Securities Contracts (Regulation) Rules, 1957. Such companies will be required to maintain at least 10 per cent shareholding for the purpose of continuous listing;
- The aforesaid minimum public shareholding requirement will not be applicable to Government companies, infrastructure companies and companies

referred to the Board for Industrial and Financial Reconstruction (BIFR);

- Listed companies, which are not presently complying with the minimum public holding requirement as mentioned above, will be given a period of two years, for compliance, from the date of issuance of circular in this regard; and
- Listed companies which may in future fall short of the requisite minimum level as mentioned above on account of reasons like Corporate Debt Restructuring (CDR) packages etc., will be given a period of one year, for compliance, from the date of non-compliance.

f. Introduction of Optional Grading of IPO

SEBI has given in-principle approval for the introduction of IPO grading at the option of the issuer. IPO grading would be done by credit rating agencies registered with SEBI. The grading is intended to be an independent and unbiased opinion of the concerned agency. It would be a one time exercise and would focus on assisting the investor, particularly the retail investors, for taking informed investment decision. SEBI will not certify the assessment made by the rating agency. An issuer who is opting for IPO grading has to disclose all gradings in the offer document. Cost of IPO grading can be met by the stock exchanges or out of the corpus maintained for Investor Education and Protection Fund.

g. Rationalisation of Disclosure Requirements for Listed Companies

Under the Listing Agreement, a listed company is required to make continuous disclosures to the stock exchanges and as such, information pertaining to such a company is already available in the public domain. However, presently, all companies, irrespective of whether they are listed or are approaching the markets for the first time with an initial public offering, are required to make the same disclosures in the offer documents/ prospectus. In order to lessen the burden of repetitive disclosures, it was decided to do away with the repetitive disclosures in case of the rights issues and public issues by the listed companies, which have satisfactory track record of filing periodic returns with the stock exchanges and have a comprehensive mechanism for the satisfactory redressal of investor grievances.

h. Abridged Letter of Offer

In case of public issues, applicants receive abridged prospectus along with the application form. However, in case of rights issues, an issuer company is required to send the letter of offer to all the shareholders along with the application form. In order to bring uniformity in the practice of making available abridged offer documents, it was decided to permit an issuer company making a rights issue to despatch an abridged letter of offer which shall contain disclosures as required to be given in the case of an abridged prospectus. The issuer company shall provide the detailed letter of offer to any shareholder upon request.

i. Disclosure of Issue Price

According to the extant guidelines, a listed company making a rights issue or a public issue is required to disclose the issue price or the price band in the draft offer document filed with SEBI, except in case of a public issue through the book building route. It was decided to henceforth allow a listed company to fix and disclose the issue price, in case of a rights issue, any time prior to fixing of the record date in consultation with the designated stock exchange and, in case of a public issue through fixed price route, at any time prior to filing of the prospectus with

the Registrar of Companies (RoC). The prospectus filed with RoC shall have one issue price.

j. Further Issue of Shares

A company was prohibited to make further issue of capital after filing a draft offer document with SEBI till the listing of the shares that are referred to in the offer document. In order to facilitate additional resource mobilisation, it has been decided to permit a company to issue further shares, provided full disclosures as regards the total capital to be raised from such further issues are made in the draft offer document.

k. Corporate Governance of Listed Companies

Investor's confidence depends largely on the corporate governance standards. According to the recommendations of the Narayana Murthy Committee, revised corporate governance standards were prescribed by SEBI. Under Clause 49 of the Listing Agreement, corporates have been advised to comply with the revised guidelines on corporate governance. Initially, the compliance date was April 1, 2005 which was subsequently extended to December 31, 2005. Without further extension of the date of compliance, certain provisions of Clause 49 were clarified in January 2006. These were: a) maximum gap between two board meetings has been increased to four months; b) sitting fees paid to the non-executive directors would not require prior approval of the shareholders; and c) certification of internal controls and internal control systems by CEO /CFO would be for the purpose of financial reporting.

II. Secondary Securities Market

a. Separate Window for Execution of Block Deals

There was a felt need in the Indian securities market to execute large trades through a single transaction without putting either the buyer or the seller in a disadvantageous position. In order to facilitate execution of large trades without impacting the market, stock exchanges were permitted to provide a separate trading window for block deals subject to certain conditions. BSE and NSE, which activated this window with effect from November 14, 2005, have to adhere to the following conditions:

- The said window is to be kept open for trading for a limited period of 35 minutes from the beginning of trading hours i.e., from 9.55 a.m. to 10.30 a.m.;
- A single block deal order has to be for a minimum quantity of 5 lakh shares or minimum value of Rs.5 crore;
- Orders can be placed at a price not exceeding ± 1 per cent from the ruling market price/previous day closing price;
- Every trade executed in this window must result in delivery and shall not be squared off or reversed;
- Details of block deals, such as, name of the scrip, client, quantity, price, etc., have to be disseminated by the stock exchanges to the general public on the same day, after the market hours; and
- All appropriate trading and settlement practices as well as surveillance and risk containment measures, etc., applicable to the normal trading segment are also applicable to this special window.

b. Review of Dematerialisation Charges

Pursuant to the representations received from the investor community and in order to encourage more investors to hold securities in demat mode, SEBI rationalised the tariff structure in the depository system relating to account opening charges, custody charges and transaction charges towards the credit

of securities with effect from February 1, 2005. However, it was observed that Depositories and Depository Participants (DPs) have been levying transaction charges for the transfer of securities from one DP to another DP although no account closure charges were levied by the depositories or DPs. In order to enable an investor, who is not satisfied with the services of a DP, to shift his Beneficiary Owner (BO) account to another DP, SEBI advised the Depositories/ DPs not to levy any charges when a BO transfers all the securities lying in his account to another branch of the same DP or to another DP of the same depository or another depository, provided the BO account/s at transferee DP and at transferor DP are one and the same. In case, the BO account at transferor DP is a joint account, the BO account at transferee DP should also be a joint account in the same sequence of ownership. This has come into force with effect from January 9, 2006.

c. Activation of ISINs of Initial Public Offerings (IPOs)

In case of IPOs, there is a time gap of about four to five days between the date of crediting of securities into the Beneficiary Owners' accounts and the date of commencement of trading of such securities on the stock exchanges. During the examination of irregularities in the allotment process of some of the IPOs, it was noticed that this time gap was utilised by a group of investors to indulge in off-market trades prior to the commencement of trading on the stock exchanges. Such off-market transactions were confined to a coterie of persons. As this type of trading denies an opportunity to other investors to deal in such securities, it was felt that the same was not in the interest of investors and therefore, should be prevented. In order to prevent such off-market transactions during the pre-listing period, SEBI advised the depositories that, in case of IPOs, the ISINs of securities can be activated only on the date of commencement of trading on the stock exchanges.

d. SEBI (Central Database of Market Participants) Regulations, 2003

The SEBI (Central Database of Market Participants) Regulations, 2003 provide for the creation of a centralised database of market participants and investors (MAPIN database) for the registration of all the market participants i.e., intermediaries, listed companies, investors, etc., in the Indian securities market by allotting a Unique Identification Number (UIN) (Box 1.2). During the process of implementation, certain concerns and apprehensions were expressed by the market participants. Therefore, SEBI constituted a Committee under the Chairmanship of Shri Jagdish Capoor to examine various operational issues and suggest appropriate measures in this regard. Meanwhile, all fresh registrations and the requirement to obtain/quote UIN under the existing MAPIN Regulations have been suspended with effect from July 1, 2005.

Keeping in view the suggestions of the Committee and also the concerns of the participants, it was decided to resume fresh registrations to obtain the UIN. The registration process will be resumed in a phased manner. To begin with, the cut-off limit for obtaining UIN with biometric impressions for natural persons has been raised from the existing limit of a trade order value of Rs.1 lakh to Rs.5 lakh or more. The limit will be reduced progressively. For a trade order value of less than Rs.5 lakh, option will be available to investors to provide either the Permanent Account Number (PAN) of the Income Tax Department or UIN obtained under MAPIN. Investors in mutual funds would be exempted from the requirement of obtaining UIN. Agencies capable of providing such facilities

Box 1.2: Unique Client Code System in India

SEBI notified SEBI (Central Database of Market Participants) Regulations, 2003 on November 20, 2003. The regulations provide for the creation of a centralised database of market participants and investors (MAPIN) through the registration of all participants in the Indian securities market by allotting a Unique Identification Number (UIN). The main objectives of MAPIN are: a) to create a unique non-duplicate ID for all investors in order to establish an audit trail for any specific transaction; b) to cover public disclosure of actions taken by SEBI against entities/ individuals; and c) to develop an inventory of all market participants (issuers/intermediaries/investors). The procedure of allotment was specified which required, *inter alia,* the use of biometric impression for UIN. SEBI had entered into a Memorandum of Understanding (MoU) with National Securities Depository Limited (NSDL) as the Designated Service Provider for creating and maintaining the MAPIN database.

Up to March 2005, 2,94,925 participants had obtained UIN. Many participants and investors expressed apprehensions and difficulties in the process of obtaining UIN which included the cost of obtaining UIN, coverage of various investor categories, biometric impression, inadequate geographical coverage etc. In order to address these issues, SEBI appointed a Committee under the chairmanship of Shri Jagdish Capoor, former Deputy Governor, RBI and currently Chairman, HDFC to look into the coverage of MAPIN and other related issues. The terms of reference for the said Committee were: i) to re-examine the coverage of the MAPIN, i.e., the category of market participants and investors who would be required to obtain UIN; (ii) to suggest future implementation schedule based on the coverage; and iii) to review the cost of obtaining the UIN for the market participants and investors.

The Committee submitted its Report on June 23, 2005. The major recommendations of the Committee are as follows:

- The capital market requires a unique ID for each participant;
- An alternative system may be put in place for creating unique ID based on non-biometrics for all participants, who are yet to obtain UINs under the existing MAPIN;
- The new system should not provide any exemptions;
- The new system should be implemented in phases;
- A technical group may be formed by SEBI to examine the implementation feasibility, cost, logistics and schedule involved; and
- The cost of issuing the UIN under the new system should be borne by SEBI and, if necessary, a very nominal fee may be levied on the applicant.

The Report of the Committee was placed on the SEBI website on June 28, 2005 for public comments. Pending a final view on the Report of the Committee, all fresh registrations and the requirement to obtain/ quote UIN under the existing MAPIN Regulations, were suspended by SEBI from July 1, 2005. Majority of the public who responded to the Report of the Committee have suggested that there may not be a need for yet another additional card as the investors are already having many cards such as voter's ID, Ration Card, Passport, PAN, etc. However, they suggested that PAN of Income Tax Department may be used as an alternative to the UIN.

Reference

Report of the SEBI Committee to Re-examine the Issues Relating to MAPIN, 2005 (Chairman: Shri Jagdish Capoor).

in a cost effective manner will be assigned the responsibility of maintaining the database. The definition of promoter, which is a body corporate would be limited to immediate holding company of the Indian entity and any of the subsidiaries, if located in India. Listed company or a company which intends to get its securities listed, along with its promoters, directors, officers and designated employees would be required to obtain the UIN. These changes will be implemented after necessary amendments are made to the MAPIN Regulations. Pending implementation of the above decision, PAN has been made mandatory for all categories of investors for opening a demat account with effect from April 1, 2006. It was also mandated that existing demat account holders are required to submit details of PAN card by September 30, 2006. If they do not produce the PAN

card or do not resolve discrepancies, if any, in the PAN details by the stipulated time, such account holders would not be able to operate their accounts with effect from October 1, 2006 and such accounts would be "suspended for debit" until PAN details are verified and updated by the Depository Participant.

e. Discontinuation of Hand Delivery Bargains/Delivery *versus* Payment

It was observed that institutional investors were relying on the mechanism of hand delivery bargains/Delivery *versus* Payment (DvP) for settlement of some of their transactions executed on the stock exchanges. Since the stock exchanges have been acting as central counterparty and providing trade/settlement guarantee through the clearing corporation/clearing house and all trades on the stock exchanges are settled through the depository system, such hand delivery bargains/DvP have outlived their purpose. Hence, with effect from September 19, 2005, all transactions executed on the stock exchanges have been mandated to be settled through the clearing corporation/ clearing house of the stock exchanges. However, hand delivery bargains have been permitted under the following exceptional circumstances such as: a) total connectivity failure to the exchange/STP (specific connectivity issues of the custodians and members shall not be considered as valid exceptions); b) international holidays that may be decided upfront by the stock exchanges in consultation with the custodians; and c) closing down of the national/international centers due to calamities.

This mandatory requirement to settle transactions through the clearing corporation/ clearing house of a stock exchange is in accordance with the international standards of clearing and settlement laid down by the Task Force of the Committee on Payment and Settlement Systems (CPSS) and the International Organisation of Securities Commissions (IOSCO).

f. Guidelines for Issuing Electronic Contract Notes

SEBI had earlier permitted brokers to issue contract notes to their clients duly authenticated by means of digital signatures, provided the brokers had obtained the digital signature certificate from the certifying authority under the Information Technology Act, 2000. In order to provide further safeguards in the process of issuing contract notes in electronic form, SEBI specified additional conditions to be complied with in this regard. These conditions include sending Electronic Contract Notes (ECNs) to a designated e-mail ID and retention of acknowledgements of receipt/proof of delivery only to such clients who have consented for the same. Wherever the ECNs have not been delivered or have been rejected by the e-mail ID of the client, the broker is obligated to send physical contract note/s to the client within the stipulated time under the extant regulations of SEBI/stock exchanges and maintain the proof of delivery of such physical contract note/s.

g. Shifting of Securities from Trade-for-Trade Segment to Rolling Settlement

Based on information provided by the depositories regarding establishment of connectivity by listed companies with both the depositories, the stock exchanges have been advised on a regular basis to shift such companies from the Trade-for-Trade segment to Rolling Settlement of the stock exchanges, subject to their having at least 50 per cent of non-promoter holdings as per Clause 35 of the Listing Agreement in demat mode. In addition to this, there should not be any other specific grounds for continuation of trading of these securities in the Trade-for-Trade segment.

h. Committee to Study the Future of Regional Stock Exchanges

Pursuant to putting in place the necessary legal framework for the corporatisation and demutualisation of the stock exchanges, it was necessary to examine the role and relevance of the Regional Stock Exchanges (RSEs) in the changed circumstances and the productive utilisation of the available infrastructure in these RSEs. In order to deliberate on these issues and make suitable recommendations in this regard, SEBI constituted a Committee under the Chairmanship of Shri G. Anantharaman, Whole Time Member, SEBI. The terms of reference for the said Committee were to review and examine:

- the future role of the RSEs and their subsidiaries – post-demutualisation, keeping in view the legal requirements of the SC(R)A;
- the manner of dealing with the assets of the RSEs in the event of withdrawal of recognition; and
- the qualitative and quantitative restrictions to be specified, if any, for limiting the investment or voting rights of prospective investors in the process of divestment of shareholding of the RSEs.

The above terms of reference included certain issues incidental to the process of demutualisation as well. Resolution of such issues arising in the post-demutualisation scenario is considered essential. The Committee has submitted its Report which has been placed on the SEBI website for public comments.

i. Policy Initiatives for Derivatives

(i) Revision of TM/FII/Mutual Fund Limits in Stock Based Derivatives

The Secondary Market Advisory Committee (SMAC) had recommended that the trading member position limits may be increased in accordance with the following broad principles:

- The revised position limits for futures should not be reduced from the present levels;
- An impetus should be provided to options trading by increasing the position limits; and
- The enhancement should not lead to concentration of positions among low cap stocks, whereas position limit of derivatives on high Market Wide Position Limit (MWPL) stocks could increase.

Accordingly, the Committee suggested to revise the trading member (TM) position limits in stock-based derivatives as follows:

- For stocks having applicable MWPL of Rs. 500 crore or more, the combined futures and options position limits shall be 20 per cent of applicable MWPL or Rs. 300 crore, whichever is lower. Within this, stock futures position cannot exceed 10 per cent of the applicable MWPL or Rs. 150 crore, whichever is lower.
- For stocks having applicable MWPL of less than Rs. 500 crore, the combined futures and options position limit would be 20 per cent of applicable MWPL and futures position cannot exceed 20 per cent of applicable MWPL or Rs. 50 crore, whichever is lower.

The Committee was also of the opinion that the enhancement of position limits applied for trading member should also be made applicable to FIIs and mutual funds. The recommendations of the Advisory Committee were approved by the SEBI Board, and SEBI specified that the aforementioned position limits should be applicable to trading by TM/FII/Mutual Funds in stock based derivative contracts. These limits have since been implemented.

(ii) Eligibility Criteria for Introduction of Derivatives on Stocks of Companies Undergoing Corporate Restructuring

According to the SEBI Secondary Market Advisory Committee (SMAC), there is a merit in having derivatives on stocks of large post-restructured companies on the first day of listing. This will be similar to having derivatives on stocks of large new companies on the first day of listing. The Advisory Committee had, therefore, recommended the eligibility conditions for derivatives trading in the stock of a post-restructured company. The SEBI Board approved the criteria for introducing derivatives on the stock of a company undergoing corporate restructuring. It was also specified that in case an unlisted company comes out with an Initial Public Offering after corporate restructuring, then derivatives may be introduced on the restructured company, provided, it fulfills the criteria applicable for companies coming out with an IPO. Accordingly, SEBI has specified the following conditions to be fulfilled to re-introduce derivative contracts on a post-restructured company's stock from the first day of listing:

- Futures and options contracts on the stock of the pre-restructured company should have been traded on any exchange prior to its restructuring;
- The pre-restructured company should have a market capitalisation of at least Rs.1000 crore;
- The post-restructured company would be treated like a new stock;
- It should be, in the opinion of the exchange, at least one-third the size of the pre-restructured company in terms of revenues, or assets, or analyst valuations; and
- In the opinion of the exchange, the scheme of restructuring should not suggest that the post-restructured company would have any feature that would render the company ineligible for derivatives trading.

For the purpose of introduction of derivatives, in case of a post-restructured company coming out with an IPO, the criteria applicable will be the same as for the introduction of derivatives on a usual company coming out with an initial public offering.

j. Corporatisation and Demutualisation of Stock Exchanges

Following amendments to the Securities Contracts (Regulation) Act, 1956 for facilitating corporatisation and demutualisation (C and D) of stock exchanges, SEBI approved and notified the C and D Schemes for 19 stock exchanges (Table 1.4).

The National Stock Exchange of India Limited and the Over-the-Counter-Exchange of India (OTCEI) have been already notified as corporatised and demutualised stock exchanges, *vide* notifications dated March 23, 2005 and September 15, 2005 respectively. Hence, NSE and OTCEI were exempted from the requirement of submission of their C and D schemes to SEBI for approval.

The C and D scheme of the Coimbatore Stock Exchange Ltd. could not be approved as it failed to submit a revised C and D scheme as advised by SEBI. As regards Mangalore Stock Exchange, SEBI refused to grant renewal of its recognition *vide* order dated August 31, 2004 and the matter is currently before the Securities Appellate Tribunal.

Under Section 4B (8) of the Securities Contracts (Regulation) Act, 1956, the demutualisation schemes of the stock exchanges will be fully implemented when at least 51 per cent of the equity share capital of the stock exchange is held by public, other than shareholders having trading rights. This should be done within twelve months from

Table 1.4: Notification of the C and D Schemes for Exchanges

Sl. No.	Name of the Stock Exchange	Date of Notification
1	2	3
1.	Bombay Stock Exchange Limited	May 20, 2005
2.	The Calcutta Stock Exchange Association Limited	August 29, 2005
3.	The Delhi Stock Exchange Association Limited	August 29, 2005
4.	The Madras Stock Exchange Limited	August 29, 2005
5.	The Pune Stock Exchange Limited	August 29, 2005
6.	The Cochin Stock Exchange Limited	August 29, 2005
7.	The Madhya Pradesh Stock Exchange	August 29, 2005
8.	The Gauhati Stock Exchange Limited	August 29, 2005
9.	The Uttar Pradesh Stock Exchange Association Limited	August 29, 2005
10.	The Hyderabad Stock Exchange Limited	August 29, 2005
11.	The Bangalore Stock Exchange Limited	August 29, 2005
12.	Vadodara Stock Exchange Limited	September 15, 2005
13.	Jaipur Stock Exchange Limited	September 15, 2005
14.	Magadh Stock Exchange Association	September 15, 2005
15.	The Ludhiana Stock Exchange Association Limited	September 15, 2005
16.	Saurashtra Kutch Stock Exchange Limited	September 15, 2005
17.	Bhubaneswar Stock Exchange Limited	September 15, 2005
18.	Inter-connected Stock Exchange of India Limited	September 15, 2005
19.	Ahmedabad Stock Exchange Limited	September 15, 2005

the notification of the order approving the C and D scheme and can be achieved either by fresh issue of equity shares to the public or in any other manner as may be specified by the regulations made by SEBI. The regulations are being framed.

III. Mutual Funds

a. Gold Exchange Traded Funds in India

Following the announcement made by the Honourable Finance Minister in his budget speech for 2005-06, Chairman, SEBI, constituted a Committee under the Chairmanship of Shri Madhukar, the then Whole Time Member, SEBI to examine the modalities for the introduction of Gold Exchange Traded Fund (GETF) Scheme in India by the mutual funds (Box 1.3).

Based on the recommendations of the Committee, the SEBI (Mutual Funds) Regulations, 1996 were amended and notification was issued on January 12, 2006 permitting the mutual funds to introduce GETFs in India. The assets of the scheme have to be kept in the custody of a bank which is registered as a custodian with SEBI. However, the scheme is subject to certain investment restrictions. The funds of any such scheme should be invested only in gold or gold related instruments in accordance with the investment objective, except to the extent necessary to meet the liquidity requirements for honouring redemptions or repurchases, as disclosed in the offer document. In case of a delay in the deployment of funds in accordance with the investment objective, the mutual fund can invest such funds in short term deposits with the scheduled commercial

Box 1.3: Gold Exchange Traded Funds in India

India is the largest consumer of gold in the world. As gold is a popular form of household savings in India, the Gold Exchange Traded Fund (GETF) was contemplated in the Indian context. Hon'ble Union Finance Minister, in his Budget Speech for 2005-06, announced that SEBI, in consultation with RBI, should permit mutual funds to introduce GETFs with gold as the underlying asset to enable any household to buy and sell gold in units for as little as Rs.100. Pursuant to this announcement, the Chairman, SEBI constituted a Committee under the Chairmanship of Shri Madhukar, the then Whole Time Member, SEBI to look into all aspects of facilitating the setting up of GETFs in India. The Committee submitted its Report to the Chairman, SEBI on September 6, 2005. The Report was sent to the central Government and was also placed in the SEBI website for public comments.

Exchange Traded Fund (ETF) is a special kind of mutual fund scheme with a very different architecture when compared with the conventional close-ended and open-ended mutual fund schemes. Typically, every ETF has three categories of players - the mutual funds, wholesale players and retail consumers. Mutual funds, which originate the ETF units, never deal in these units on the secondary market. They do transactions only with the wholesale players. So far as the common investors are concerned, they used to buy/sell ETF units from/ to the wholesale intermediary on the exchange. Retail consumers also trade ETF units among themselves on the stock exchange screen. In India, ETFs were introduced in 2001 and by September 2005, there were 6 ETF schemes together having total assets under management of Rs.1,700 crore.

GETF scheme is a special type of ETF. While ETF can have multiple underlying assets, GETF has gold as the sole underlying asset. Presently, GETF schemes are operational in three countries, namely, the USA, Australia and South Africa in different forms. The Committee on GETF examined five models of GETF, of which two were finally suggested as suitable options for implementation in the Indian conditions. These are: Mutual Fund Bank Integrated Model and Mutual Fund Warehouse Receipt Model. In case of the former, the physical gold is held by the custodian bank on behalf of the mutual fund. The mutual fund buys/sells units from/to a wholesale intermediary based on the value of the gold with the custodian bank and the wholesale intermediary in turn sells/buys the units to/from the retail investors on the stock exchange. In the mutual fund warehouse receipt model, gold warehouse receipts are held by a custodian bank on behalf of the mutual fund. The mutual fund sells/buys units to/from a wholesale intermediary based on the value of the gold warehouse receipts with the custodian bank and the wholesale intermediary in turn sells/buys the units to/from the retail investors on the stock exchange.

The GETF unit is considered as a security under the Securities Contracts (Regulation) Act, 1956. Such units are spot instruments, distinctly different from the gold futures. These are freely transferable among the participants through the stock exchange mechanism. The GETF is a definite step forward for the modernisation of the spot gold market by offering an anonymous trading framework characterised by a nationwide participation by the households. The GETF offers several advantages such as zero concerns about physical security, theft or adulteration; a transparent secondary market which offers reduced transaction costs; and the possibility of using GETF units as collateral for loans. Although the unit holders will not have any right on the underlying asset, they are entitled to the accrued benefit on the scheme by way of dividend and market arbitrage.

Reference

Report of the Committee on Gold Exchange Traded Funds, SEBI Bulletin, January 2006.

banks. The initial issue expenses should not exceed six per cent of the funds raised under the scheme.

b. Minimum Number of Investors in Scheme(s)/Plan(s) of Mutual Funds

According to the SEBI guidelines, the mutual fund schemes/plans which existed on the date of the issue of circular *i.e.*, December 12, 2003 and did not have a minimum of 20 investors and with one investor holding more than 25 per cent of the corpus was required to be wound up by December 31, 2004. Taking into consideration the suggestions received from the Association of Mutual Funds of India (AMFI) and in order to harmonise the methodology for calculating the 25 per

cent limit, it was clarified that the above circular would be applicable at the portfolio level. If there is a breach of 25 per cent limit by an investor over the quarter, a rebalancing period of one month would be allowed. Further, a 15 days notice will be given to the investor to redeem exposure over the 25 per cent limit, failure of which would lead to automatic redemption by the mutual fund on the 15th day of the notice period on the applicable Net Asset Value.

c. Unique Client Code (UCC) for Mutual Fund Scheme(s)/Plan(s)

All mutual funds were advised by SEBI to maintain the secrecy of Unique Client Code (UCC) which may be furnished only to the member broker through whom the mutual funds were trading. In order to facilitate the unit holders to claim tax benefit associated with the payment of Securities Transaction Tax (STT), it was decided to allow mutual funds to share the UCC of their schemes/ plans with their unit holders.

d. Investments in ADRs / GDRs / Foreign Securities by Mutual Funds

Mutual funds are permitted to invest in ADRs/GDRs and foreign securities. However, in many cases, disclosures pertaining to investment in ADRs/ GDRs/ foreign securities were not made in the offer document. All the mutual funds, in such cases, were advised to send a written communication to the investors about the proposed investment. They were also advised to communicate the risk factor associated with such investment to each unit holder prior to the investment in such securities. In addition, an advertisement about the proposed investment needs to be given by the mutual fund in one English daily newspaper having nationwide circulation as well as in a newspaper published in the language of the region where the head office of the mutual fund is located. This provision is not applicable to the existing mutual fund schemes where relevant disclosures regarding investment in ADRs/ GDRs/ foreign securities have already been made.

e. Review of Time Limit for Updating NAV on AMFI Website

In view of the difficulties faced by mutual funds in adhering to the time limit of 8 p.m. for uploading all the NAVs including those of Fund of Funds schemes on the AMFI website, the time limit was extended up to 9 p.m.

f. Venture Capital Funds

The SEBI (Venture Capital Funds) Regulations, 1996 were amended *vide* Gazette Notification dated January 25, 2006 to permit a venture capital fund to invest in securities of foreign companies subject to such conditions or guidelines that may be stipulated or issued by the Reserve Bank of India and SEBI from time to time.

IV. Foreign Institutional Investors

FII Investment in Debt Securities

Hon'ble Finance Minister in his Budget Speech for 2006-07 announced to enhance the sub-ceiling for FII investment in debt securities within the overall limit of External Commercial Borrowings (ECBs). While such limit for Government securities (including Treasury Bills) was raised from US $ 1.75 billion to US $ 2.00 billion, the same for the corporate debt had been increased from US $ 0.5 billion to US $ 1.5 billion. The sub-ceilings continued to remain separate and not fungible.

V. Corporate Restructuring

a. Takeovers

In order to provide flexibility to corporate restructuring, it was decided to amend SEBI

(Substantial Acquisition of Shares and Takeovers) Regulations, 1997. The amendment aims at striking a balance between the twin objectives of providing flexibility to the companies to restructure their capital in an orderly manner and maintaining the minimum public shareholding which is required for continuous listing. In the process of corporate restructuring under the new Takeover Regulations, if the target company's public shareholding falls below the prescribed minimum, the restoration of minimum public shareholding will take place through a framework provided in the revised Clause 40 A of the Listing Agreement. As a move towards flexibility, the amendments include, *inter alia*, removal of restrictions on market purchases and preferential allotments. The outgoing shareholder (promoter) can sell the entire stake to the incoming acquirer in case of takeover. Further, shareholders holding more than 55 per cent would be able to make further acquisitions subject to making an open offer. The notification relating to the said amendment is being issued.

b. Delisting of Securities

The delisting of securities from the stock exchanges is governed by the SEBI (Delisting of Securities) Guidelines, 2003 which came into effect on February 17, 2003. On January 31, 2006, SEBI amended the provisions of compulsory delisting thereby providing a mechanism for determining fair value of shares in case of compulsory delisting by an expert group appointed by the stock exchanges. This amendment seeks to simplify the existing framework by amending certain procedural anomalies that are prevailing in the provisions relating to compulsory delisting and hence making it possible for stock exchanges to delist shares of errant companies which are not complying with the Listing Agreement.

VI. Investor Awareness/Assistance and Investor Education/Protection

a. Redressal of Investors' Grievances

SEBI has a comprehensive investor grievances redressal mechanism at its head office as well as at the regional offices. The Office of Investor Assistance and Education (OIAE) is the single window interface through which SEBI interacts with investors. SEBI takes up investor complaints with companies and registered intermediaries on a regular basis. In order to file complaints, there is a standardised format which is available at all SEBI offices and on the SEBI website for the convenience of investors. SEBI has a simple and efficient internet-based response system for investor complaints. A system generated acknowledgement letter is issued to the investors as soon as a complaint is received electronically. Investors have the option of filing the complaints online or submitting the same on plain paper. Investors who visit the SEBI offices or access the investor helpline are guided regarding the appropriate authority to lodge their complaints which are outside the jurisdiction of SEBI.

If the companies fail to redress complaints in spite of repeated reminders by SEBI, regulatory actions are initiated under Section 11B (debarring companies from accessing the capital markets) and 15C (imposing of monetary penalty) of the SEBI Act, 1992. Up to March 31, 2006, 33 companies have been referred for adjudication proceedings under Section 15C of the SEBI Act, 1992. Prohibitory orders have also been passed under Section 11B of the SEBI Act, 1992 against errant companies which did not redress the investor grievances. Such orders have been passed against 12 companies and 53 directors till now. Moreover, SEBI also issues the status of investor grievances every fortnight for public

information and uploads the same on the SEBI website.

During the period 1991-92 to 2005-06, SEBI received 28,80,580 grievances from the investors of which a total of 27,23,060 grievances were redressed by the respective entities, indicating a redressal rate of 94.53 per cent (Table 1.5).

b. Securities Market Awareness Campaign

SEBI believes that *'An Educated Investor is a Protected Investor.'* In order to educate the investors, a comprehensive Securities Market Awareness Campaign was launched on January 17, 2003. The campaign includes workshops, audio-visual clippings, distribution of educative materials in English, Hindi and local languages, a dedicated investor website with inventory of booklets / pamphlets/ FAQs and periodic advertisements in All India Radio (AIR) and print media. Several workshops were arranged throughout the country to reach the common investors and educate them about the functioning of the capital market. Keeping in mind the geographical spread of the investors throughout the country, SEBI decentralised the campaign in association with various market participants, banks etc. During 2005-06, 1000 workshops were conducted under the aegis of Securities Market Awareness Campaign. Till March 2006, 2,949 workshops were conducted covering around 485 cities/towns in the country.

There are standardised reading and presentation materials for the workshops in addition to reference guides on topics such as rights and responsibilities of investors, substantial acquisition of shares and takeovers, simple 'dos and don'ts' relating to various aspects of the securities market,

Table 1.5: Redressal of Investor Grievances

Year	Grievances Received		Grievances Redressed		Redressal Rate Percentage (cumulative)
	During the year	Cumulative	During the year	Cumulative	
1	2	3	4	5	6
1991-92	18,794	18,794	4,061	4,061	21.61
1992-93	1,10,317	1,29,111	22,946	27,007	20.92
1993-94	5,84,662	7,13,773	3,39,517	3,66,524	51.35
1994-95	5,16,080	12,29,853	3,51,842	7,18,366	58.41
1995-96	3,76,478	16,06,331	3,15,652	10,34,018	64.37
1996-97	2,17,394	18,23,725	4,31,865	14,65,883	80.38
1997-98	5,11,507	23,35,232	6,76,555	21,42,438	91.74
1998-99	99,132	24,34,364	1,27,227	22,69,665	93.24
1999-00	98,605	25,32,969	1,46,553	24,16,218	95.39
2000-01	96,913	26,29,882	85,583	25,01,801	95.13
2001-02	81,600	27,11,482	70,328	25,72,129	94.86
2002-03	37,434	27,48,916	38,972	26,11,101	94.99
2003-04	36,744	27,85,660	21,531	26,32,632	94.51
2004-05	54,435	28,40,095	53,361	26,85,993	94.57
2005-06	40,485	28,80,580	37,067	27,23,060	94.53

mutual funds, etc. These reference materials are also available in Hindi. In addition, the workshop materials are available in 10 regional languages too. There is an investor website (http://investor.sebi.gov.in) from where the investors can get all the relevant information at one place. This website is regularly updated.

c. Recognition to Investor Associations

For a country like India with a wide geographical spread, a rapidly growing investor population needs many strong investor groups before they are granted the responsibility of standing up for other retail investors. SEBI recognises investor associations and extends financial support for conducting investor education programmes and also addresses various issues raised by them to protect the interest of the investors. SEBI has so far recognised 10 Investor Associations which are as follows:

- Consumer Education and Research Society;
- Consumer Unity and Trust Society;
- Investor Education and Welfare Association;
- Investors Grievances Forum;
- Midas Touch Investors Association;
- Tamilnadu Investors Association;
- The Gujarat Investors and Shareholders Association;
- Rajkot Sahar/Jilla Grahak Suraksha Mandal;
- Kolhapur Investors' Association; and
- Society for Consumers' and Investors' Protection.

d. National Institute of Securities Markets (NISM)

The Hon'ble Union Finance Minister, in his Budget Speech for 2005-06, authorised SEBI to set up a National Institute of Securities Markets (NISM) for teaching and training intermediaries in the securities market and promoting research. The NISM has been registered as a 'Society' under the Societies Registration Act, 1860. A plot of land measuring more than 60 acres at Patalganga near Panvel, Mumbai, has been purchased from the Maharastra Industrial Development Corporation (MIDC) to build a world-class infrastructure for NISM. The NISM would design and implement the entire gamut of educational initiatives, including education, training, certification, research and consultancy in the area of securities market and allied subjects for securities market professionals in India and the neighbouring countries. This would complement SEBI's endeavor to: a) promote investors' education; b) train intermediaries in the securities market; and c) conduct research necessary for discharging its responsibilities.

Details of the blue print for NISM, including sourcing of funds, business model, possible collaboration, physical and human capital, curriculum, course design and delivery of education and training etc., are being worked out to make the NISM operational at the earliest.

e. Training for the Financial Journalists

There has been a long standing request from the financial journalists of the print and electronic media to have an interface with SEBI on issues relating to the capital market. As financial journalists play a critical role for investors' education, SEBI decided to conduct a one-day workshop on capital market for the financial journalists at different centers. The objective of the program was to provide adequate inputs to the financial journalists for balanced reporting of financial events and shoulder the responsibility of accurate dissemination of information on the

developments that are taking place on a day-to-day basis in the securities market. This programme was organised at New Delhi and Chennai during 2005-06. At both the places, the programme was inaugurated by Shri M. Damodaran, Chairman, SEBI. A few outside experts, including professors and practitioners, were invited for an interface with the participants in addition to presentations given by the senior officers of SEBI. As the response was encouraging, SEBI is contemplating to conduct the same programme in other centers during 2006-07.

VII. Retrospect and Prospects

a. Retrospect

Indian economy continued to sustain a high rate of growth during the Tenth Five Year Plan period so far. There was a robust growth of over 8 per cent during 2005-06. The momentum in manufacturing and services sector was maintained resulting in higher capacity utilisation and increased business confidence.

The investors' confidence was reflected in the activities of the capital market too. An unprecedented bull run was observed in the Indian securities market with the BSE Sensex crossing the 10000-mark for the first time on February 6, 2006 and 11000-mark on March 27, 2006. During 2005-06, the BSE Sensex gained by 73.7 per cent which was the third highest, next to Colombia (IGBC Index) and Russia (CRTX Index). Backed by strong macro-economic fundamentals, the overall market sentiment was buoyant throughout the year, except in October 2005. Reflecting the price appreciation, market capitalisation to GDP ratio and the traded value to GDP ratio increased to 85.6 per cent and 67.7 per cent, respectively in 2005-06 from 54.4 per cent and 53.4 per cent a year ago. The rally in the capital market was broad based with all the sectors registering significant gains. Besides FIIs, mutual funds and retail investors were also active in the secondary market.

In consonance with the extremely firm trend in the secondary market, the number of companies accessing the primary market increased to 139 in 2005-06 from 60 in the previous year. The amount mobilised in 2005-06, net of offer for sale, was higher at Rs. 27,104 crore in 2005-06 compared to Rs. 25,056 in 2004-05. The number of Initial Public Offerings (IPOs) increased in 2005-06. All the companies which approached the market with IPOs in 2005-06 were from the private sector except Gujarat State Petronet Ltd. The number of rights issues in 2005-06 also increased to 36 from 26 in 2004-05.

There was an exponential increase in the mobilisation of resources by mutual funds in 2005-06. With private sector mutual funds dominating the resource mobilisation efforts, the net resources mobilised by all mutual funds was substantially higher at Rs. 52,779 crore during 2005-06 compared to Rs. 2,200 crore in 2004-05. The exposure of mutual funds to the equity segment increased significantly, commensurate with higher mobilisation of resources under the equity schemes.

The FIIs continue to consider India as a favoured investment destination. The number of FIIs registered with SEBI went up to 882 by end March 2006 from 685 a year ago. Their net investment in equities at US $ 10,981 million in 2005-06 surpassed the earlier record.

b. Prospects

In a deregulated environment, the capital market has to play a critical role in channelising resources from the savers to the investors in a more efficient manner. In this context, better investor protection, improved corporate governance, adequate disclosures

and stricter risk management system assume paramount importance. SEBI would continue its endeavour to fine-tune its policies and programmes keeping in view the mandatory objectives assigned to it under the Securities and Exchange Board of India Act, 1992.

India has a developed Government securities market. However, the corporate debt market is yet to be developed. Although, there is a wholesale debt market segment at BSE and NSE, the trading in corporate debt is negligible. Honourable Finance Minister announced a package of measures in 2005-06 Budget including the setting up of an Expert Committee on corporate bonds. Subsequently, a High Level Expert Committee was constituted under the Chairmanship of Dr. R.H. Patil, Chairman, Clearing Corporation of India Limited (CCIL) to suggest appropriate measures for the development of corporate debt market in India. The Expert Committee submitted its report to the Government on December 23, 2005. The recommendations of the Committee have been accepted by the Government. SEBI has set up an internal Committee for the implementation of Patil Committee recommendations. The road map for developing a vibrant corporate debt market is being drawn up.

The stock exchanges world over have been generally formed as mutual organisations. The ownership, trading rights and management are often vested with the same set of persons. This leads to conflict of interest between ownership and management. In order to segregate the management function from the ownership and trading rights, there was a need for demutualisation of stock exchanges. Moreover, stock exchanges should function as body corporate similar to any other 'for-profit' corporate entity. In India, NSE and OTCEI have been corporatised and demutualised. Corporatisation and Demutualisation (C and D) of stock exchanges is a priority item in the SEBI agenda. The oldest stock exchange of the country, namely, The Stock Exchange, Mumbai became a limited company on August 19, 2005 and the demutualisation process has been initiated. Barring Coimbatore Stock Exchange and Mangalore Stock Exchange, C and D of other stock exchanges have been notified, which will take some time to complete the process. In the meantime, modalities are being worked out for increasing the public shareholding of the stock exchanges above 51 per cent.

The activities of the regional stock exchanges (RSEs) have dwindled to a negligible level during the recent years. Most of the RSEs have been thriving by floating subsidiaries for trading at BSE and NSE. In the post-demutualisation period, it has become crucial to decide the future role of RSEs. A Committee was set up under the Chairmanship of Shri G. Anantharaman, Whole Time Member, SEBI to study the future of RSEs in the Indian context. The Anantharaman Committee has submitted its report to the Chairman, SEBI and the same has been placed on the SEBI website for public comments. SEBI has to decide on the future of RSEs on the basis of the recommendations of the Anantharaman Committee.

As indicated earlier, while presenting the Union Budget for 2005-06, Honourable Finance Minister announced the setting up of a National Institute of Securities Markets (NISM). Under the initiatives of SEBI, NISM has been registered as a society. Modalities are being worked out to set up this institute at an appropriate location in the suburb of Mumbai. SEBI has already acquired a plot of land at Patalganga near Panvel from the Maharastra Industrial Development Corporation (MIDC). The Institute is likely to build a cadre of professionals who can undertake the specialised functions relating to the securities market.

The Unique Identification Number (UIN) is very much necessary to identify the transactions in the securities market. Registrations for obtaining UIN under SEBI (Central Database of Market Participants) Regulations, 2003 (MAPIN) were suspended keeping in view certain operational difficulties. On the basis of the recommendations of the Committee set up by SEBI (Chairman: Shri Jagdish Capoor), it has been decided to resume registrations under MAPIN in phases with biometric impression for high value transactions.

The Secondary Market Advisory Committee (SMAC) has brought out a Discussion Paper on short selling and securities lending and borrowing (Box 1.4). In order to make the short selling system effective, a revised system of securities lending and borrowing would be required in addition to other safeguards suggested by SMAC. Based on the final recommendations of SMAC, SEBI would consider a suitable framework to be put in place.

Box 1.4: Short Selling of Securities in India and Abroad

In the stock market literature, 'selling of securities that the seller does not own at the time of trade' is known as short selling. It has been a subject of considerable debate as conflicting views have been put forward across the world. The critics of short selling view it as a potential risk that can destabilise the market. The exponents consider short selling as a desirable feature of the securities market as it improves efficiency of the market through price discovery and enhances liquidity of the related securities. Indeed, most of the securities market regulators world-wide have recognised short selling as a legitimate investment activity and permitted short selling transactions in their respective jurisdictions with adequate safeguards to prevent any abusive/manipulative market practices. The Securities and Exchange Commission (SEC) of the US is of the view that although the majority of short sales are legal, abusive short sale practices are illegal. The International Organisation of Securities Commissions (IOSCO) has reviewed short selling and securities lending practices across markets and has recommended transparency of short selling, rather than prohibit it. Many emerging markets like Hong Kong, Korea, Japan, Singapore etc., have permitted short selling in their respective jurisdictions on certain designated securities subject to disclosure of such transactions and tick rules which prohibit short selling transactions during a falling market. The crux of the issue is, therefore, to have sufficient safeguards to avoid potential risks and simultaneously reap the benefits associated with short selling.

In India, the issue of short sales was first deliberated in 1996 when SEBI constituted a Committee under the Chairmanship of Shri B.D. Shah. Pursuant to the recommendations of the Shah Committee and also to address the issue of lack of transparency then existing in the stock exchanges, all member brokers of stock exchanges were required to submit their scrip-wise net short sale positions to the exchanges at the end of each trading day in respect of 60 actively traded scrips with effect from November 29, 1996. Subsequently, the disclosure was also extended to include the net long positions. In June 1998, SEBI had temporarily banned short sales in response to market volatility. Although, 1998 ban of short sales was withdrawn quickly, it was reintroduced in March 2001 following extreme conditions of market volatility. With the introduction of rolling settlement with effect from July 2, 2001, SEBI withdrew ban on short sales. At present, there is no prohibition on short sales by retail investors. The 'institutional investors' *viz.*, FIIs and mutual funds registered with SEBI, banks, insurance companies are expressly prohibited under the respective regulations or statutes from short selling and are required mandatorily to settle on the basis of deliveries of securities owned and held by them. At present, there is no distinction between naked and covered short sales in any regulation or any statute governing the securities market. Naked short sales would now show up as settlement shortages. In this context, the Joint Parliamentary Committee (JPC) in December 2002 observed "that SEBI must look into these issues seriously and expeditiously formulate a clear policy taking all aspects into account". The issue of short sale was reviewed by the Secondary Market Advisory Committee (SMAC) on several occasions since 2003 and recently, it came out with a Discussion Paper. The major recommendations of the SMAC include, *inter alia*, the following:

- Institutional investors who are currently prohibited, should be permitted to short sell;

Box 1.4: Short Selling of Securities in India and Abroad *(Contd.)*

- Institutional investors should not indulge in day-trading;
- Naked short selling should not be permitted and all investors would be required to mandatorily honour the obligation of delivering the securities at the time of settlement;
- The stock exchanges should frame a uniform penalty structure and take appropriate action against the brokers for failure to deliver securities at the time of settlement which would act as a sufficient deterrent against naked short selling;
- In the absence of a vibrant market for securities lending and borrowing, short selling may not work effectively. Therefore, a full fledged securities lending and borrowing scheme must be put in place to provide the necessary impetus for short selling;
- To begin with, short selling may be permitted only in those stocks in which derivative products are available;
- Institutional investors would be obligated to disclose upfront at the time of placement of order whether the transaction is a short sale and demonstrate their ability to borrow securities to the satisfaction of the broker. However, the retail investors would be permitted to make a similar disclosure before the end of the trading hours on the transaction day;
- To ensure sound audit trail, all stock brokers should be mandated to maintain sufficient documentation regarding the ability of their clients to borrow and deliver securities at the time of settlement;
- Margin on short selling transactions by the institutional investors should be similar to those executed by the retail investors;
- Lending and borrowing transactions should be executed on an automated, screen based platform which enables real time matching of the demand and supply; and
- Stock exchange should disseminate the information on lending and borrowing transactions to the general public.

Reference

1. *SEBI (2005), Discussion Paper on Short Selling and Securities Lending and Borrowing.*
2. *FSA (2002), Discussion Paper on Short Selling (No. 17).*

India's capital market has undergone rapid transformation during the last one and a half decades. The capital market issues have become more complicated due to integration of financial markets, both domestically and internationally. Given the evolving nature of the financial system in general and the capital market in particular, the existing regulations often become obsolete. Hence, there is a need to fine-tune the existing regulations through constant reviews. SEBI has been active in reviewing its regulatory framework by setting up various working groups, technical committees, etc. In this context, mention may be made about the Kania Committee which has given wide ranging suggestions for strengthening the regulatory framework (Box 1.5). Steps are being taken to implement the Kania Committee recommendations.

India's Gross Domestic Saving as proportion to GDP reached a peak of 29.1 per cent (new series) in 2004-05. The household savings were at the peak level of 23.5 per cent (gross) in 2003-04. However, investment in shares and debentures by the households was hardly 0.2 per cent of GDP. According to the SEBI-NCAER investor survey, 7.4 per cent of households directly participated in the Indian securities market in 2000 as against about 50 per cent in the USA. Low level of household participation in the securities market in India is a matter of concern for SEBI. There is a need for launching third investor survey. Preliminary work has been done to identify an agency to conduct investor survey on behalf of SEBI. The findings of the survey may be useful to understand as to how more and more households could be attracted towards the securities market.

Box 1.5: Report of the Expert Group for Suggesting Amendments to Securities and Exchange Board of India Act, 1992 (Chairman: Mr. Justice M. H. Kania)

Capital markets are being integrated world-wide. Amidst this backdrop, the IMF and World Bank have drawn up a Financial Sector Assessment Programme to strengthen the monitoring of financial systems. SEBI, in its mission to achieve the best global standards in consonance with the standards set by IMF, appointed an Expert Group on August 5, 2004 under the Chairmanship of Mr. Justice M. H. Kania, former Chief Justice of India. The terms of reference were: a) to identify the deficiencies / inconsistencies in the existing provisions of the SEBI Act; b) to suggest new provisions that can be incorporated in the SEBI Act to make it more effective and investor friendly; and c) to take into account recommendations of the JPC as also recommendations of other expert groups constituted by SEBI from time to time in this regard. The Group submitted its Report on July 12, 2005. The recommendations of the Group are divided into three parts. Part One contains new provisions that are recommended for amendments to the SEBI Act so as to strengthen investors' interests, make regulations more efficient and enhance regulatory jurisdiction. Part Two of the Report recommends proposed amendments for changes in the existing provisions of SEBI Act. Part Three of the Report looks into consequential and related amendments in other Acts. Major recommendations of the Group are furnished below:

Part One:

- Setting up of a separate investor protection fund under the SEBI Act on the lines of Subscriber Education and Protection Fund under the PFRDA Ordinance 2004.
- Provisions with regard to nomination facility for investors should exist in the parent Mutual Funds Act and not merely in the Regulations.
- Advance Guidance may be considered as the same is sought after by market participants for interpretation of the provisions of the SEBI Act.
- It is desirable to empower SEBI to rectify the clerical or typographical errors apparent in its own orders, on the lines of Section 26 (2) of the Recovery of Debts due to Banks and Financial Institutions Act, 1993.
- Amendment to the SEBI Act on the lines of Section 295(4) of the Income Tax Act, 1961 may be made to empower SEBI to make regulations with retrospective effect in matters related to charging of fees or procedural matters for the limited purpose of giving relief and benefit and not for imposing new liabilities and obligations.
- None of the provisions in the SEBI Act deserved to be given an overriding effect.
- The statutory power to declare fraudulent issue of securities, excess dematerialisation of securities etc., as void should be performed by an independent body, preferably by the civil courts.
- Suitable provision in the SEBI Act may be made to enable SEBI to file winding up petition in respect of the intermediary companies on the lines of Section 45MC of the Reserve Bank of India Act and Section 43A of the Banking Regulation Act.
- On the issue of distinction and segregation of investors' funds from the assets of other entities, there should be a specific provision in the SEBI Act to that effect.

Part Two:

- The SEBI Act may be amended to include market intermediaries such as asset management company, research analyst, clearing corporation, clearing bank, stock lender, STP Service Provider, who are not expressly included in Section 12 of the SEBI Act.
- To amend the SEBI Act to empower SEBI to call for information from professionals, subject to the professional's constitutional rights.
- Chapter VIA of the SEBI Act may be amended to empower SEBI to initiate adjudication proceedings for imposing monetary penalty for furnishing false information knowingly.
- Section 11(2) (Ia) of the SEBI Act may be amended to authorise SEBI to share information on reciprocal basis with overseas regulators.
- To replace the words 'any company' used in the Section 11A (b) (i) by the words 'any person' to expand the purview of the said Section.
- To amend Sections 11 (2A), 11C (9) and 11D so as to bring them in harmony with Section 12A of the SEBI Act.
- To increase the period of attachment of bank account of intermediaries from the present period of one month to three months subject to the order of a first class Judicial Magistrate in writing.
- For the sake of clarity in Sections 15A to 15H of the SEBI Act, words "one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less" may be replaced by "not exceeding one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees".

Box 1.5: Report of the Expert Group for Suggesting Amendments to Securities and Exchange Board of India Act, 1992 (Chairman: Mr. Justice M. H. Kania) *(Contd.)*

- To provide for monetary penalty for the failure to comply with the orders of SEBI, Section 15HB and Section 24 (2) of the SEBI Act may be amended.
- Suitable amendment may be made to the SEBI Act to utilise all the penalty amounts realised under Chapter VIA of SEBI Act for investors' protection and education.
- To ensure that hearing proceedings are not held up in the absence of a member of the Bench, the Group recommended for amendment in the SEBI Act empowering the Presiding Officer to constitute benches consisting of one member or two members for hearing any appeal or interim application.
- To avoid frequent reconstitution of SAT, the tenure of a member may be increased to 65 years.
- The cooling off period of two years for a SEBI official to hold office in SAT may be reduced to one year under proviso to Section 15M (2) of the SEBI Act.
- Compounding of all violations and offences, recommended on the lines of provisions contained in Section 279 (2) of Income Tax Act 1961.
- Amendment to Section 26 of the SEBI Act proposed to provide that the person conducting prosecution on behalf of SEBI, under the SEBI Act before the Sessions Court shall be deemed to be a public prosecutor.
- To dispense with the compulsory presence of the SEBI officials at every stage of SAT hearing, an amendment in Section 26 of SEBI Act recommended on the lines of Section 621(1A) of the Companies Act, 1956.
- Office of Single Enquiry and Adjudicating Authority may be created through appointment made by the Chairman / Whole Time Member. The appointed authority may decide the matter of imposition of penalty under the SEBI Act and the Rules/Regulations made thereunder.
- Under Section 19 of the SEBI Act, SEBI can delegate its powers and functions. Therefore, Section 19 of the SEBI Act may be amended to replace the references to Section 29 by Section 30.

Part Three:

- SEBI may exercise powers under Section 11A of the SEBI Act to specify additional disclosures to be made by the companies whereas the power to amend Schedule II of the Companies Act may remain with the Central Government.
- The Central Government may delegate its powers to SEBI, thereby making SEBI the sole authority to administer the provisions of SC(R)A in terms of Section 29A of the SC(R)A.

As discussed earlier, investor education assumes importance in the context of very low level of household participation in the Indian capital market. A number of initiatives have been taken in this direction. A comprehensive Securities Market Awareness Campaign was launched in January 2003 through workshops, media-prints, advertisements etc. Moreover, SEBI has a comprehensive investor grievances redressal mechanism. The Office of the Investor Assistance and Education (OIAE) is the single window interface through which SEBI interacts with the investors and takes up the complaints with concerned entities, either directly or by the Investor Complaint Cell of the concerned department. SEBI would continue its endeavour to educate the investors.

Indian capital market is increasingly being integrated with the international markets. In view of this, there is a need to monitor developments in the overseas markets, particularly the flow of FII investment to the emerging markets. Sustained increase in the prices of assets such as gold, real estate and securities together is a major concern among the policy makers throughout the world. Another disquieting development is the high and sustained crude oil prices which has the potential to slowdown the growth process, particularly in the oil importing countries and thereby affect the asset prices. There is also world-wide apprehension about the growing imbalances of macro-economic parameters of the developed countries. The emerging economies may have to be in

readiness to respond appropriately in case of rapid corrections of such imbalances. In addition to monitoring international developments, SEBI has to further strengthen its surveillance mechanism in the domestic market.

Investors' confidence depends largely on the corporate governance standards. SEBI recently constituted a Committee on corporate governance under the chairmanship of Shri Narayana Murthy to examine the existing corporate governance practices and suggest improvement, wherever necessary. Based on the Narayana Murthy Committee Report, revised corporate governance standards have been prescribed. Corporates were advised to comply with the revised guidelines on corporate governance including appointment of independent directors by December 31, 2005 under Clause 49 of the Listing Agreement. SEBI would continue its endeavour not only to enforce corporate governance standards in India, but also strengthen them further.

Honourable Finance Minister proposed several initiatives in the Budget for 2006-07 for strengthening the capital market. Further liberalisation has been made in the debt market. The outstanding limit for investment in G-sec by FIIs has been raised from US $ 1.75 billion to US $ 2.0 billion. Similarly, the limit on FII investment in corporate debt has been raised from US $ 0.5 billion to US $ 1.5 billion. The ceiling on Indian Mutual Funds investing in overseas instruments has been increased from US $ 1 billion to US $ 2 billion with removal of requirement of 10 per cent reciprocal share holding. Other major proposals relating to capital market were: a) to set up an Investor Protection Fund under the aegis of SEBI, funded by fines and penalties recovered by SEBI; b) to provide equity support of Rs. 16,901 crore and loan of Rs. 2,789 crore to Central PSEs; c) to create a single unified exchange traded market for corporate bonds; d) raising of STT by 25 per cent across the board; e) open-ended and close-ended mutual funds to be treated at par for the purpose of exemption from the dividend distribution tax; and f) acceptance of recommendations of High Level Expert Committee on corporate bonds. SEBI is working on these proposals to implement them at the earliest.

Keeping in view the Budget proposals and also to pursue the on-going reform initiatives as discussed above, the major agenda for SEBI during 2006-07 would be as follows:

- Developing a corporate debt market in India;
- Corporatisation and Demutualisation of stock exchanges;
- Determination of the future role of the Regional Stock Exchanges in the post-demutualisation period;
- Expansion and diversification of the derivatives trading;
- Setting up of the National Institute of Securities Markets (NISM);
- Initiation of fresh registrations in phases to obtain the Unique Identification Number (UIN) under SEBI (MAPIN) Regulations, 2003;
- Introduction of short selling of securities by institutional investors with adequate safeguards;
- Further simplification and rationalisation of securities market regulations;
- Conducting of investors survey;
- Expansion of investors' education;
- Improving the market surveillance system; and
- Strengthening corporate governance standards.