

## PART I

### POLICIES AND PROGRAMMES

The Annual Report of the Securities and Exchange Board of India (SEBI) for the financial year (FY) 2000-01, reviews the policies and programmes of the SEBI, its working and operations, and the developments in Indian securities market during the financial year. It also describes the manner in which the SEBI discharged its functions in fulfillment of the twin objectives of investor protection and market development mandated by the Securities and Exchange Board of India Act, 1992 (the Act) and exercised its power conferred on it by the Act; the Securities Contracts (Regulation) Act, 1956 (SCRA); the Depositories Act, 1996 as well as in terms of the delegated powers under the Companies Act, 1956. The Report has been prepared in accordance with the format prescribed in the Securities and Exchange Board of India (Annual Report) Rules, 1994, notified in the Official Gazette on April 7, 1994. The SEBI has been constantly reviewing and reappraising its existing policies and programmes, formulating new policies and crafting new regulations to nurture areas hitherto unregulated and to implement them to promote the growth and to ensure that the Indian securities markets work with efficiency and integrity and to protect the interest of investors. The major reforms and developments in the securities markets during 2000-01 are given in Box 1.1.

#### Box 1.1: Major Policy Reforms and Developments in Securities Markets during 2000-01

##### *Streamlining of the Disclosure and Investor Protection Guidelines*

- To ensure availability of adequate information to investors, the guidelines issued to companies to disclose the details of utilization and deployment of unutilized part of promoter's contribution, firm allotment and reservation in their balance sheet. Similar requirements also specified in case of monies accrued to the company as a result of a preferential issue. Companies required to indicate the purpose for which such monies are utilised and the form in which such unutilised monies have been invested.
- To address apprehensions about an overly optimistic future performance by the company, no forecast or projections relating to financial performance of the issuer company to be given in the offer document.

##### *Book-building*

To further strengthen the book-building and to rationalise the existing provisions of book-building guidelines and to introduce greater transparency in the book-building process, following guidelines issued

- 100 percent one stage book-building permitted with bidding centres at all cities having stock exchanges.
- The provision of 75 percent of the issue to be offered through book-building of which :
  - ✓ 60 percent to be allocated to institutional investors such as banks/FIIs and other financial institutions and at least 15 percent to be distributed on proportionate basis to non-institutional investors applying for more than 1000 shares and
  - ✓ The remaining 25 percent of shares to be available to small investors.

##### *Entry Norms and Book Building*

Book building process further used to strengthen and streamline the entry point norms for public issues and to help investors make better judgement of quality and price of the issue on the assumption that QIBs who would be subscribing first to the offer under the book building have ability to assess the quality of the investment and their investment decision would effectively amount to a market appraisal of the quality and price of the issue.

- Issuers not having net-worth of Rs. 1 crore and distributable profits in 3 out of the immediately preceding 5

(contd. on next page)

*(contd. from previous page)*

years or proposing to raise more than 5 times its pre-issue net worth, required to make issues to be compulsorily through book-building route offering 60 percent to Qualified Institutional Buyers (QIBs).

- Institutional investors under the category of QIBs like banks, FIs, mutual funds and other financial institutions to be allocated not more than 60 percent of the book-built portion.

#### Preferential Allotment Disclosures and Lock-in

- To safeguard investors' interest, guidelines on preferential allotment modified requiring companies to include detailed disclosures in the explanatory statement in the notice for the general meeting or AGM of the shareholders. viz. objective of the issue and intention of promoters, directors, key management persons, shareholding pattern etc.
- Lock-in period of one year from the date of allotment stipulated for instruments allotted on preferential basis to any person including promoters/promoter group except for such allotments which involve share swap for acquisitions.

#### Promoters Contribution and Lock-In

- To ensure promoters' association and commitment to company and to enhance investors' confidence in public issues of unlisted companies, the minimum promoters contribution of 20 percent for unlisted companies required to be locked-in for 3 years and the balance of the entire pre-IPO capital to be locked in for 1 year from the date of commencement of commercial production or the date of allotment in the public issue which ever is later.

#### IPOs in Dematerialised Mode

- To eliminate the problems relating to loss of allotment letters, share certificates, etc., and to induce the investors to opt for allotment of dematerialised shares, the trading for all IPOs in dematerialised form made compulsory with an option available to the investors for physical shares.

#### Guidelines for Issue of Debt Instruments

- To help the development of debt market and to provide a wider variety of debt instruments the SEBI (Disclosure and Investor Protection) Guidelines, 2000 amended to allow issuers to issue unsecured/subordinated debt instruments with maturity of less than 18 months in the nature of mezzanine capital.

#### Public Issues Through Stock Exchange Mechanism

- To reduce issue costs as well as time taken in public issues, guidelines issued for offering securities in public issues through the stock exchange mechanism, giving the issuers the option to issue securities through the on-line system of the stock exchange or through the existing banking channel.

#### Allotment Procedure

- To speed up the listing process, in- principle approval from the stock exchanges for listing of securities required to be obtained by the lead merchant banker within 15 days of filing of the offer document with the stock exchange.
- To ensure speedier completion of the issue process, and to minimize the risks associated with volatile markets, the time for finalising allotment reduced from 30 to 15 days in book-built issues and the period between finalisation of basis of allotment and listing reduced to 7 working days to impart quicker liquidity to the investments made in primary issues.
- To ensure that investors get the shares/ refund orders quickly, the despatch of share certificates/refund orders/cancel stock invest and demat credit required to be completed within two working days of finalisation of the basis of allotment, in place of present requirement of 30 days.
- To further simplify the present allotment procedure, market lots replaced with simple proportionate allotment to the applicants in the respective categories. To prevent fractional allotments and allotments of miniscule

*(contd. on next page)*

*(contd. from previous page)*

value, the minimum allotment to be higher of the following: a) one share or b) smallest integral number of shares that have a value of Rs. 1000/- calculated on the basis of issue price.

#### Relaxation of Minimum Offer to Public

- To encourage companies in the new economy while ensuring good quality issues with sufficient stock available for trading:
  - ✓ Indian companies in information technology, media, entertainment and telecom sectors permitted to access the markets with a minimum offer of 10 per cent of post-issue capital to the public subject to a minimum offering of 20 lakh shares for the amount of not less than Rs.50 crore. This relaxation subsequently extended to all companies with the same conditions and the issue size increased from Rs. 50 crore to Rs. 100 crore.
  - ✓ The restriction of minimum public issue size of Rs. 25 crore in case of an IPO through book-building removed for all companies.

#### Listing of Debt Before Equity

- The present facility of listing of debt securities of infrastructure companies and municipal corporations without having listed their equity, extended to all companies subject to investment grade credit rating, promoters' contribution of 20 per cent, three years lock-in, maintaining same standard of continuing disclosures, no partly paid-up shares/ other securities, and book-building option, etc.

#### Financial Disclosures Requirements for Issuers and Other Entities

To strengthen the financial disclosures norms for the listed entities :

- The unaudited financial quarterly results of the companies made more transparent and meaningful, additional disclosure norms prescribed and half-yearly results subjected to a "limited review" by the auditors,
- The issuers required to prepare cash flow statement referred to in the listing agreement in accordance with relevant accounting standard,
- The issuers required to disclose materially significant transactions, i.e., transactions of the company of material nature, with its promoters, the directors or the management, their subsidiaries or relatives, etc. which may have potential conflict with the interests of issuers at large,
- The public disclosure of details of non-compliance, penalties, strictures imposed by the stock exchange or the SEBI or any matter of company related to the capital market during the last three years required; and separate disclosure for all material on non-recurring/abnormal income/gain and expenditure/loss and effect of all changes in accounting practices affecting the profits materially,
- All stock exchanges and subsidiaries of stock exchanges, clearing corporations advised to post their annual accounts in their respective websites, besides making available a copy of their annual accounts to investors, intermediaries and general public.
- Valuation methods standardised for net asset value of mutual funds for debt securities, thinly traded and non-traded debt and equities.
- The ICAI issued accounting standards for consolidation of accounts, segment reporting, related party transactions, deferred tax liability.
- These standards will be mandatory for all listed companies as per the phased programme of corporate governance issued by SEBI.

#### Corporate Governance

- The recommendations of the Kumar Mangalam Birla Committee on corporate governance in relation to listing agreement entered into by the companies with the stock exchanges implemented.
- According to the recommendations of the Accounting Standards Committee, the companies required to immediately disclose all material information simultaneously to all the stock exchanges where the securities of the company are listed.

*(contd. on next page)*

*(contd. from previous page)*

- The regional stock exchanges required to disseminate the information to all stock exchanges where the securities of the company are listed or traded .
- Further, any material event arising out of decisions taken in the board meetings regarding announcement of results, dividends, bonus, rights etc. are to be furnished to the stock exchanges within fifteen minutes of the closure of the board meetings.
- The companies to report extent of compliance of corporate governance in their Annual Reports.
- The stock exchanges directed to monitor corporate governance compliance on quarterly basis.

#### Continuous Listing

- Guidelines issued to all listed companies to maintain a minimum level of non-promoter holding on a continuous basis as a measure of investor protection as it would ensure availability of floating stocks.

#### Rolling Settlement

- Rolling settlement which was first introduced voluntarily from January 1998 on all scrips included in the demat segment and then compulsorily to 163 scrips to be expanded to 414 scrips by covering additional 251 scrips from July 2, 2001 following the announcement made by the Government on March 13, 2001 in Parliament.
- The list of additional 251 scrips to include all scrips having the facility of ALBM / BLESS or MCFS in any stock exchange. In addition if there is any scrip which is included in the BSE 200 scrip but not covered by the above list also to be included in the compulsory rolling settlement on a nation-wide basis.
- All deferral products cease to be available from July 2, 2001 except for the limited purpose of liquidating the outstanding positions till September 3, 2001. However liquidation of outstanding deferral positions as of the date of announcement of SEBI decision to take place by September 3, 2001.
- Simultaneously exchanges permitted to introduce stock options from July 2, 2001 .

#### Risk Containment Measures:

##### A) Rationalisation and strengthening of Margin System

- Margins of 10 per cent made applicable for exposures up to Rs. 20 crore and 15 per cent made applicable for exposures exceeding Rs. 20 crore and up to Rs.40 crore or a uniform rate of 12.5 per cent margin made applicable under MCFS and ALBM .
- Price band for 200 scrips and scrips under compulsory rolling settlement, was relaxed to 16 per cent.
- Scrip limit in carry-forward position in Modified Carry-Forward System (MCFS) or the trade position in Automated Lending and Borrowing Mechanism (ALBM) was fixed at Rs 5 crore per scrip per member in account period and also in rolling settlement, and the exposure limit was fixed at Rs. 4 crore per broker.
- No volatility margin in compulsory rolling settlement system.
- Cash component to be minimum at 30 per cent of the total margin, to be deposited by the broker.
- To encourage delivery based transactions, the margins to be provided only in the shape of bank guarantees and cash component need not be insisted.
- Several measures taken following the events in the stock market in March 2001.

##### B) Price Band :

To further strengthen the risk management system the following measures adopted:

- The price bands initially placed at 8 per cent such that once a scrip touched the 8 percent price band in either direction, the trading in that scrip to be restricted upto the price band for half an hour, and thereafter, the price band to be further relaxed by 4 percent in the direction in which the price moved to touch the ceiling .
- The relaxation of the price band could only be done at BSE or NSE. The other exchanges to relax the price band (by 4 percent ) only after such relaxation is applied at BSE or NSE.

*(contd. on next page)*

*(contd. from previous page)*

- Subsequently, the price band was relaxed by further 8 per cent for 200 actively traded scrips jointly decided by BSE and NSE.
- Following the events in the securities markets in March 2001 all transactions to be backed by delivery unless the sale transaction has been preceded by a purchase position of at least an equivalent amount in the name of the same client in the same or any other exchanges. This restriction was temporary, to be removed depending on the condition of the market.

#### Mandatory Client Code

- To help establish the identity of buyers and sellers of securities and to improve and facilitate market surveillance, the client code made mandatory at the brokers' level operating on all the stock exchanges.
- The unique client code also to be introduced across exchanges.

#### Abolition of No - Delivery Period

- No-delivery period of seven days abolished for companies whose securities are traded in the compulsory dematerialised mode.

#### Code of Ethics for Directors and Functionaries of Stock Exchanges

- 'Code of ethics' for directors and functionaries of stock exchanges introduced to raise the professional and ethical standards of exchanges and their functionaries and also to avoid conflict of interest, and promote market integrity.

#### Delivery Versus Payment (DVP)

- To bridge the gap between pay-in and pay-out of securities and funds, the DVP Committee set up to look into the mechanism for efficient payment and delivery system for securities and funds simultaneously. The recommendations of the committee awaited.

#### Trading and Settlement of Securities in Dematerialised Form

- To protect the interest of investors and enhance the safety of the dematerialisation process, additional safeguards introduced. Directives issued to depositories/depository participants to standardize the account opening procedure and to maintain the list of account holders. Additional guidelines also issued for proper verification of the debit instruction slips.
- To enhance the efficiency of the dematerialisation process and to prevent any possible misuse of pool account balances, directives issued to the depositories and depository participants, to reduce the pool account balances, to restrict the use of pool account balances only for effecting deliveries in the particular settlement and to levy penal charges for failure to reduce the pool account balances after the stipulated period.

#### Derivatives Trading

- To provide liquidity to the market and to enable market to absorb larger shocks for a small change in the prices, the derivatives trading was approved in June 2000 first in index futures contracts, both at NSE and BSE.
- Derivative products were expanded subsequently to include options on indices and thereafter to options on individual stocks.
- The risk containment measures for exchange traded index futures contracts outlined by the SEBI under the framework consistent with the risk management guidelines. The exchanges are free to adopt any risk management model available globally.

#### Internet Trading

- To provide benefits to investors as an added advantage of convenience, transparency and real time trading, the internet based trading allowed through order routing system which will route client orders to exchange trading systems for execution of trades on the stock exchanges.

*(contd. on next page)*

(contd. from previous page)

#### Securities Lending Scheme

- To facilitate smooth securities settlement, the schemes of ALBM and BLESS transactions of NSE and BSE, respectively, as generic products.

#### Investor Education

- A Working group appointed on investor education which recommended application of information booklets on dematerialisation, secondary and primary market operations, imparting education on radio and television.

#### Mutual Funds

- A common format prescribed for all Mutual Fund schemes to disclose their entire portfolios on half yearly basis so that the investors can get meaningful information on the deployment of funds. Mutual Funds also required to disclose the investment in various types of instruments and percentage of investment in each scrip to the total NAV, illiquid and non performing assets, investment in derivatives and in ADRs and GDRs.
- To bring about transparency in the investment decisions, and ensure due diligence of the AMCs in their investment of public funds, all the AMCs directed to maintain records in support of each investment decision which would indicate the data, the facts and other related opinion leading to an investment decision.
- Further the AMCs required to record the basis for taking individual scrip-wise investment decision in equity and debt securities and report its compliance in their periodical reports to the trustees. After checking its compliance through independent auditors or internal/statutory auditors, the trustees required to report to SEBI in their half-yearly reports.
- To enable the investors to make informed investment decisions guidelines issued to mutual funds to fully revise and update offer document and memorandum atleast once in two years.
- Mutual funds also required to :
  - ✓ bring uniformity in disclosures of various categories of advertisements, with a view to ensure consistency and comparability across schemes of various mutual funds,
  - ✓ reduce initial offer period from a maximum of 45 days to 30 days,
  - ✓ despatch statements of account once the minimum subscription amount specified in the offer document is received even before the closure of the issue,
  - ✓ invest in mortgaged backed securities of investment grade by Credit Rating Agency,
  - ✓ identify and make provisions for the non-performing assets (NPAs), according to criteria for classification of NPAs and treatment of income accrued on NPAs and to disclose NPAs in half yearly portfolio reports,
  - ✓ disclose information in a revised format on unit capital, reserves, performance in terms of dividend and rise / fall in NAV during the half year period, annualized yields over the last 1, 3, 5 years in addition to percentage of management fees, percentage of recurring expenses to Net Assets, investment made in associate companies and payment made to associate companies for their services, details of large holdings etc. since their operation
  - ✓ declare their NAVs and sale / repurchase prices of all schemes updated daily on regular basis on the AMFI web site by 8:00 p.m. and declare NAVs of their close-ended schemes on every Wednesday
- To give operational flexibility, mutual funds also allowed to constitute committees who can approve proposals for investment in unrated debt instruments after being approved by the AMC board and the trustees

#### Foreign Institutional Investors (FIIs)

- To avoid discrimination between Indian and foreign fund managers, the SEBI (Foreign Institutional Investors) Regulations 1995 amended on February 29, 2000 to permit domestic fund managers to also manage foreign funds.
- To facilitate investment by FIIs, foreign corporate bodies and foreign individuals permitted to invest upto 5 per cent of the total issued capital of the company.
- To further facilitate the foreign inflows the FIIs and sub-accounts permitted to invest in commercial papers

(contd. on next page)



(contd. from previous page)

- To facilitate disinvestment in holding by FIIs which did not desire to renew registration, SEBI (Foreign Institutional Investors) Regulations, 1995 amended.

*Venture Capital Funds (VCFs)*

- To facilitate automatic transfer of shares from Venture Capital Funds or Foreign Venture Capital Investors to promoters of a venture capital undertaking, exemption granted from applicability of Open Offer requirements based on the recommendations of Shri K B Chandrasekhar Committee on Venture Capital.

The SEBI had set certain targets to be achieved in the short and medium term . The achievements of the SEBI during the year under review measured against the targets set out in the previous Annual Report of the SEBI are presented in (Table 1.1).

**Table 1.1 Targets and Achievements**

<b>Targets Set Out in the Annual Report of 1999-2000</b>	<b>Achievements in 2000-01</b>
1. To achieve complete and full implementation of corporate governance framework.	The guidelines of SEBI on corporate governance have been implemented through the amendment of the listing agreement of the stock exchanges. The mandatory guidelines were made applicable first to all the listed companies included either in group A of the BSE and the S & P CNX Nifty index. In their Annual Reports, the corporates have to report the extent of compliance of the guidelines. The SEBI has issued directions to stock exchanges to follow up the compliance of corporate governance by the companies. The ICAI issued accounting standards for consolidation of accounts, segment reporting, deferred tax liability, related party transactions and earnings per share. Some of these standards are mandatory for all companies. Those which are not mandatory will be made mandatory for all those listed companies for which corporate governance code is applicable as per the phased programme.
2. To further strengthen the rolling settlement system.	The SEBI has further strengthened rolling settlement system. The list of scrips under compulsory rolling settlement was expanded to cover all scrips included in the ALBM/BLESS or MCFS in any stock exchange for all stock exchanges from July 2, 2001. In addition, if there is any scrip which is included in the BSE 200 list, but not covered by the above list, was also to be included in the compulsory rolling settlement on a nationwide basis. Rolling <i>(contd. on next page)</i>

<i>(contd. from previous page)</i>	settlement for the remaining scrips would be introduced from January 2002 and till that time these scrips will be traded on uniform settlement cycle (Monday - Tuesday) in all stock exchanges.
3. To further strengthen the clearing and settlement system and to speed up the process of dematerialisation and dematerialised trading.	SEBI announced the programme of dematerialisation to cover all actively traded scrips on all stock exchanges by March 31, 2001. SEBI also took several measures to ensure procedural safety and simplification of dematerialisation. Besides a group was also set up to suggest steps for moving towards DVP.
4. To set up a risk management group to further refine the existing margining system with a view to reducing the transaction cost without affecting the safety and addressing the risk arising from market volatility.	A risk management group was set up, and several measures were taken to streamline and strengthen the risk management system.
5. To encourage wider use of internet for trading and other activities in the securities market.	The SEBI permitted Internet based trading through order routing system and has prescribed minimum technical standards for ensuring safety and security of transactions between clients and brokers. The NSE and BSE have already permitted their brokers to start internet based trading. SEBI also permitted WAP based trading.
6. To continue efforts for bringing uniform bye-laws for stock exchanges.	A committee on uniform bye-laws for stock exchanges has submitted its report regarding the uniform rules. The report is being examined. In the meanwhile, the SEBI has been continuously reviewing the existing bye-laws in consultation with the stock exchanges, so that the bye-laws reflect the changes and new developments taking place in the market structure and the administrative structure of the stock exchanges. The bye-laws of the stock exchanges are thus now uniform across all stock exchanges.
7. To increase the role of venture capital funds.	The SEBI has notified the guidelines for Foreign Venture Capital Investor Regulation, 2000 for registration and regulation of foreign venture capital investment in India following the announcement made by the Finance Minister in the Budget of 2000-01.
8. To strengthen the process of book-building.	Several measures have been taken to promote the use of book building and simplify and <i>(contd. on next page)</i>



<i>(contd. from previous page)</i>	streamline the process and increase the efficiency of book-building. To strengthen the book-building process, the SEBI has permitted 100 per cent one stage book-building at bidding centres in all cities having stock exchanges. Companies having no track record can make IPOs only through the book-building route provided 60 percent is allotted to QIBs and companies which want to issue only 10 percent as minimum offering as post issue capital to public, have also to come through book-building. These steps will promote the growth of book-building process.
9. To enhance the role of market making.	The SEBI issued guidelines based on the recommendations of the committee on market making to stock exchanges to permit brokers to take up market making in the equity shares of a company in whose case the number of trades is more than 50 and the value of trade on daily basis is more than Rs.10 lakh. The activity has, however, not picked up.
10. To implement derivative trading on the exchanges.	The SEBI granted final approval to derivatives trading at NSE and BSE on May 25, 2000. The SEBI in principle permitted trading in Futures Contracts based on BSE Sensex and S & P CNX Nifty indices. The SEBI has also approved trading in options related to index based futures contract. The guidelines for risk containment measures in relation to derivatives trading were also issued.
11. To continue upgrading and widening the disclosure norms for the protection of the investors.	SEBI streamlined disclosure guidelines for issues in the primary market and further strengthened the financial disclosure requirement for the listed companies. Detailed guidelines on disclosure norms to mutual funds were also issued.
12. To strengthen the surveillance and monitoring system at the exchanges.	Efforts were made to strengthen surveillance and monitoring of the stock exchanges. The exchanges had introduced the stock watch system. A code of ethics were also introduced for all stock exchanges.
13. To develop programme for investor education to enhance the awareness of securities market.	The SEBI has taken a number of initiatives to educate investors. SEBI distributed nearly 1 crore booklets entitled 'A Quick Reference <i>(contd. on next page)</i>

<i>(contd. from previous page)</i>	<p>Guide for Investors' and guided other agencies to provide printed information on educational aspects of investments to investors. As such BSE released a diary on information relating to primary market, secondary market and derivatives. NSE distributed more than 1 lakh copies of its publication on investors education. The AMFI published and distributed a booklet on 'Making Mutual Funds Work For You', BSE and NSE again were supposed to distribute booklets on dematerialisation and secondary and primary market operations. This printed material was distributed in Hindi also.</p>
14. To develop measures to strengthen links with stock exchanges and regulatory authorities in foreign countries.	<p>SEBI has taken steps to strengthen links with stock exchanges and regulatory authorities in foreign countries through participation at the meetings of the President's Committee, Executive Committee, Technical Committee and Emerging Markets Committee of IOSCO and in the meetings of Financial Services Forum (FSF). The Chairman, SEBI is chairman of the Emerging Markets Committee and a member of Executive Committee of IOSCO and FSF . Besides, SEBI has signed an MoU with the Malaysian Securities commission during the year.</p>

## **A] REVIEW OF THE GENERAL ECONOMIC ENVIRONMENT AND THE INVESTMENT CLIMATE**

### **General Economic Environment**

During 2000-01, the economic growth according to estimates of Central Statistical Organisation (CSO) slowed down by 1.2 percentage points as the GDP in real terms (at 1993-94 prices) recorded a lower growth of 5.2 per cent as against a growth of 6.4 per cent during 1999-2000. All the three sectors namely agriculture (from 0.7 per cent to 0.2 per cent), industry (from 6.1 per cent to 5.3 per cent) and services (from 9.6 per cent to 7.7 per cent) registered fall in their respective growth rate during 2000-01 over the previous year. Services sector despite the fact that it experienced a noticeable fall in its growth from 9.5 per cent in 1999-2000 to 7.5 per cent in 2000-01, improved its share from 53.0 per cent in 1999-2000 to 54.2 per cent in 2000-01.

Trends in domestic saving and domestic investment have been the cause of concern. According to the data available so far, domestic saving ratio has been practically constant at low level of 22.0 per cent of GDP during 1998-99 and 22.3 per cent during 1999-2000. The saving ratio compares very unfavorably with the achievement of 25.1 per cent in 1995-96. Consequently, domestic investment(gross capital formation) has also decelerated from 26.5 per cent in

1995-96 to 23.3 per cent in 1999-2000. Public sector continued to show disappointing performance as its saving rate was negative at 1.2 per cent in 1999-2000 compared to a lower negative rate of 0.8 per cent in the previous year. The private sector saving rate, however, remained constant at 3.7 per cent in 1999-2000 as it was in the previous year. However, household saving which was 19.1 per cent in 1998-99 increased to 19.8 per cent in 1999-2000. Household savings in financial assets, which had increased from 9.9 per cent of GDP in 1997-98 to 10.9 per cent in 1998-99, declined to 10.5 per cent in 1999-2000. Households savings in terms of physical assets, however, improved from 8.0 per cent in 1997-98 to 8.2 in 1998-99 and further to 9.2 per cent in 1999-2000. This implies that households have been diverting their savings from financial assets to physical assets.

There was a compositional change in the structure of financial assets of households. It would be observed from Table 1.3 that share of investment in shares and debentures which had increased from 2.9 per cent in 1997-98 to 6.4 percent in 1999-2000 declined to 2.7 per cent in 2000-01. On the otherhand share of contractual savings increased from 30.1 percent to 33.4 percent during the same period. When comparison is made between 2000-2001 and 1999-2000, it is observed that investments in shares and debentures registered decline from 6.4 percent to 2.7 percent where as share of deposits increased from 39.1 percent to 44.3 percent and share of currency decreased from 8.5 percent to 6.4 percent.

Foreign inflows strengthened the external position of India as total foreign exchange reserves at the end of March 2001 increased to US\$ 42.3 billion from US\$ 38 billion at the end of March 2000. These favourable achievements of the economy have sustained the external credibility of the country in the perception of foreign equity investors.

On exchange rate front the Re against the US\$ depreciated by about 7 per cent between April and October 2000 and forex market witnessed considerable instability. The foreign inflows amounted to US\$ 3.3 billion during April-February 2000-01 as compared to US\$ 5.2 billion during the previous year.

The primary market which had shown a growth of 40 per cent in resource mobilisation from Rs.5586.5 crore in 1998-99 to Rs.7816.8 crore in 1999-2000, suffered a set back in 2000-01. The total resources mobilised declined to Rs. 6107.8 crore in 2000-01 recording a fall of 21.9 per cent. The decline in resource mobilisation from the market was contributed by both public issues as well as rights issues. The public issues reported a decrease of 14.0 per cent whereas rights issues were lower by 53.3 per cent than the amount reported during the previous year. It was significant that fresh capital raised by the listed companies declined by more than 33.6 per cent whereas capital raised through IPOs was sustained at the level achieved last year.

The secondary market recorded subdued trend and stock prices as measured by the BSE Sensex in 2000-01 on point to point basis, declined from 5001 as on March 31, 2000 to 3604 as on March 30, 2001 or by 27.9 per cent. Other indices like BSE 100, NSE 50 and S & P CNX 500 dropped by 41.7 per cent, 24.87 per cent and 42.9 per cent respectively, during the same period. There was a sharp fall in equity market capitalisation. The market capitalisation of NSE which stood at Rs.10,20,426 crore at end March 2000 substantially and continuously declined to Rs. 6,57,847 crore recording a fall of 35.5 per cent over the year. The market capitalisation at

BSE declined from Rs.9,12,842 crore to Rs.5,71,554 crore during the same period at the rate of 37.3 per cent.

The stocks prices in March 2001 were volatile. From October 2000 to the middle of February 2001, the Sensex rose from a level of around 3700 to 4300. Thereafter, the market was, however, in a declining trend. On February 28, 2001 the day of Union Budget 2001 the Sensex opened at 4070 and rose by 177 points to 4247, recording an eleven month peak for a single day. There was also a rise of 24 points in the Sensex on March 1, 2001 to 4271. However on March 2, 2001 the index reported a sharp fall of 176 points from the closing of March 1, 2001 to 4095. The Sensex, thereafter, showed a declining trend. The intra-day decline was of 246 points. The market behaviour following the budget raised the apprehension of market manipulations. The SEBI, therefore, took several measures to address various concerns to safeguard the interest of the investors. SEBI also began investigating several stock broking entities and other market participants for market manipulation. The specific measures undertaken by the SEBI in March 2001 were as follows:

- The threshold limit for the applicability of the volatility margin was reduced from 80 per cent to 60 per cent so as to bring more scrips under the ambit of the volatility margin.
- No exemptions were allowed in the applicability of volatility margin to any class of investors and that the volatility margins were made applicable to sale positions of financial institutions, foreign institutional investors banks and mutual funds.
- All the scrips in MCFS/ ALBM and BLESS were to attract additional margin @ 10 per cent on end of the day net outstanding sale position.
- All sales transactions effective from March 8, 2001 were required to be backed by delivery unless a sale transaction is preceded by a purchase position of at least an equivalent amount in the name of the same client in the same or any other exchange. This was to be applicable to the proprietary trading by members, on a self-certification basis and is subject to exchange off-site inspection upto sub-broker and client level. The exchanges were required to share information to facilitate the verification. It was made applicable to scrips in the MCFS, ALBM, BLESS and other deferral products.
- The current margining system was moved to the VaR scrip-wise model from July 01, 2001.
- The additional margin of 10 per cent on the “end of the day” net outstanding sale position of all scrips in Modified Carry Forward System (MCFS)/ Automated Lending and Borrowing Mechanism (ALBM) and Borrowing and Lending of Securities Scheme (BLESS) imposed on March 5, 2001, was increased to 25 per cent with effect from March 12, 2001
- A ceiling was placed on the broker-wise end of the day outstanding position (aggregate of all securities) of a member on any stock exchange other than the BSE/NSE to Rs.50 crore with effect from March 12, 2001. The BSE and NSE were excluded from the purview of this stipulation in view of the size of their trade and settlement guarantee funds.
- The gross exposure limit for the members of the stock exchanges was reduced to 10 times of the base capital and the additional base capital in the case of NSE and to 15 times for the other stock exchanges with effect from March 12, 2001.

The stock exchanges were permitted to use the settlement guarantee fund maintained by them for meeting the shortages arising out of the non-fulfillment/partial fulfillment of the funds obligations by the members in the settlement before declaring the concerned member defaulter. This is in line with the practice followed by the NSE. This is also in accordance with the international practice.

Besides the above measures, the SEBI also began investigations against some market participants. Further, in the interest of investors and the orderly development of the securities market in India, the following actions were taken :

- Shri Anand Rathi was restrained from acting as a Director of the Governing Board of the Stock Exchange, Mumbai until further notice.
- Shri Anand Rathi and his concerns were directed not to undertake any fresh business as a broker, till further orders are passed by SEBI in this regard.
- All broker member directors of the Stock Exchange, Mumbai were restrained from acting as directors on the governing board of the Stock Exchange, Mumbai until further notice.

On the Calcutta Stock Exchange, 10 members were declared defaulters. Those of the defaulters who were board members resigned. Other elected members of the Calcutta Stock Exchange also resigned from the committee of the exchange on March 30, 2001.

On March 13, 2001, the Government of India announced measures on the floor of the Parliament to improve institutional mechanisms and trading practices in stock market. First was the corporatisation of stock exchanges by which ownership, management and trading rights would be segregated from each other. The rolling settlement as a second measure was extended to 200 category 'A' stock in MCFS, ALBM and BLESS schemes by July 2001. SEBI took steps to implement these announcements. As mentioned elsewhere in this Annual Report, SEBI had already announced the list of additional 251 scrips to be covered in rolling settlement from July 2, 2001 and the programme of rolling settlement to cover the rest of the market by January 2002. SEBI is also drawing a plan for corporatisation and demutualisation of the stock exchanges.

Interestingly, the volatility in stock prices in India during financial year 2000-01 showed by and large a declining trend except for certain months. The BSE Sensex, which displayed a volatility of 3.9 per cent in April 2000, recorded an average volatility of 1.6 per cent by October 2000. In March 2001 volatility in the market of the BSE Sensex increased to 2.9 per cent but was lower than April 2000. Volatility of BSE Natex, which was 3.8 per cent in April 2000, declined to 1.8 per cent in February 2001 but rose back to 3.3 per cent in March 2001. The S&P CNX Nifty demonstrated a volatility of 3.5 per cent in April 2000 which decreased to as low as 1.2 per cent by January 2001.

The average daily turnover at BSE and NSE which had risen from Rs.2,071 crore and Rs.2,606 crore in March 1999 to Rs.4,050 crore and Rs.5,028 crore in March 2000 markedly declined to Rs.2,150 crore and Rs.2,867 crore in March 2001 respectively. There was a fall of 46.9 per cent in case of BSE and 42.8 per cent in case of NSE turnover.

The trading pattern at the bourses has shown varying trends during 2000-01. While, of the total traded companies, 40.6 per cent were traded at BSE for above 100 days and 25.9 per cent were traded for less than 10 days, at NSE, 79.4 per cent companies were traded for above 100 days and 14.1 per cent were traded for less than 10 days.

Mutual funds, mobilised Rs. 9,128 crore on a net basis in 2000-01 less than half of the amount mobilised in 1999-2000 at Rs. 18,970 crore. Though the gross mobilisation by the mutual funds sharply increased from Rs. 61,241 crore in 1999-2000 to Rs. 92,957 crore in 2000-01, net mobilisation markedly declined due to increased repurchase/redemption. During 2000-01, in almost all the months gross sales of equity shares by mutual funds was more than the gross purchases indicating large disinvestment by mutual funds during the year. On the other hand, gross sales of debt instruments were less than the purchases in almost all the months reflecting that mutual funds' net investment in this instrument was positive during the year. The disinvestment of mutual funds may have had downward impact on equity prices during the year.

Foreign Institutional Investors (FIIs) continued to repose their confidence in Indian securities market as their net investment aggregated to about US\$ 2.2 billion in 2000-01 as compared to a figure of US\$ 2.3 billion during the previous year.

**Table 1.2: Trends in Gross Domestic Savings**

(As percentage of GDP at current market prices)

Sector	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000 Q
Households	19.7	18.1	17.0	17.8	19.1	19.8
Private Corporate	3.5	4.9	4.5	4.2	3.7	3.7
Public	1.7	2.0	1.7	1.5	-0.8	-1.2
Total	24.8	25.1	23.2	23.5	22.0	22.3

Q = Quick Estimates.

Source : Economic Survey, 2000-01.

**Table 1.3: Financial Assets-wise Distribution of Households Savings in Percentage Share**

(Rs. in crore)

Item	1997-98	1998-99P	1999-00P	2000-01 #
Financial Assets (Gross)	171740	209664	244143	264669
Currency	7.4	10.4	8.5	6.4
Deposits @	46.6	39.3	39.1	44.3
Claims on Government	12.9	13.5	11.9	13.1
Shares and Debentures ++	2.9	3.6	6.4	2.7
Contractual Saving**	30.1	33.3	34.2	33.4

# preliminary P: provisional @ Comprise bank deposits, non-bank deposits and trade debt(net) ++ Including units of UTI and other MFs. \*\* Comprise LIC,PF and Pension Funds

Source: RBI Annual Report 2000-01



## **BJ REVIEW OF POLICIES AND PROGRAMMES**

A review of the major policies and programmes adopted by the SEBI during 2000-01 is given below:

### **i. Primary Securities Market**

The following paragraphs discuss the measures taken by the SEBI in the primary market during the year 2000-01.

#### *Strengthening of eligibility norms*

- During the year under review, the SEBI further strengthened and streamlined the eligibility norms for accessing the capital market in order to enhance the level of investors' protection and to rationalise the procedures for the issue of capital. Hitherto, companies could access the primary markets if (i) they had a track record of distributable profits in terms of section 205 of the Companies Act for atleast 3 out of the immediately preceding 5 years and a pre-issue networth of not less than Rs. one crore in 3 out of the immediately preceding 5 years or (ii) if their project was appraised by a bank or a financial institution which had financed atleast 10 per cent of the project cost. The rationale underlying the second norm was that an appraisal of the project by a bank/FIs would give an indication of its soundness to the prospective investors. Further, financing the project to the extent of 10 per cent, would ensure long term participation and monitoring by the bank / financial institution which was expected to give confidence to the investors about the future prospects of projects. It was observed that in practice the norm did not serve its intended purpose. The requirement of appraisal by a Bank/FI was also done away with.
- If the issuer did not have a stipulated net worth or track record of distributable profits or if the issuer is a listed company which proposed to raise more than 5 times its pre-issue networth, the revised guideline require the issue to be compulsorily made through book-building route wherein 60 per cent of the offer has to be allotted to Qualified Institutional Buyers (QIBs). In case 60 per cent cannot be allotted to QIBs the issue will have to fail. The QIBs have been defined to include QIBs financial institutions, banks, mutual funds, foreign institutional investors, multilateral and bilateral development financial institutions and venture capital funds registered with SEBI.
- The underlying rationale for this entry norm is that under the book-building procedure, the issue quality is appraised by well informed investors – the QIBs and the price is decided on the basis of their bids. Thus, a level playing field is created for the investing public who now have the facility of the issue having already been appraised by large market players before they put in their applications. This measure provides safety to retail investors by reason of market appraisal and price acceptance by well informed investors.

The above mentioned entry norms would also be applicable to companies, which propose to make an offer for sale.

Any listed company which has changed its name to indicate that it is a company in the information technology sector during a period of 3 years prior to filing of offer document with

SEBI, would also be required to comply with the entry norms prescribed for public issues by unlisted companies.

### **Relaxation of requirement of minimum offer to public**

- Earlier companies could access the primary market only if they offered a minimum of 25 per cent of their post-issue capital to the public as prescribed under Rule 19(2)(b) of Securities Contracts (Regulations) Rules, 1957. This requirement of minimum 25 per cent was a deterrent to going public, thus depriving the Indian public to participate in issues of sound companies as the companies floated their issues abroad. In order to facilitate availability of good quality paper in the Indian markets, Indian companies in Information technology sector were permitted to make a public offer upto 10 per cent of the post-issue capital instead of 25 per cent subject to minimum offering of 20 lakh shares for an amount not less than Rs. 50 crore. In August 2000, this relaxation was extended to companies in the media/entertainment and telecom sector also and on December 12, 2000 this benefit of offering only 10 per cent of post-issue capital to the public was made available to all sectors subject to the condition of minimum offering of 20 lakh shares. However, in order to ensure a wide float, it was stipulated that the minimum issue size should be increased from Rs. 50 crore to Rs. 100 crore. Companies not fulfilling the aforesaid conditions are required to make a minimum public offering of 25 per cent. For this purpose, SEBI recommended to the Government to suitably modify Rule 19(2)(b) of SCRR, 1957 to provide for offering of minimum 10 per cent of post-issue capital subject to the aforesaid conditions.
- The restriction of minimum public issue size of Rs. 25 crore in the case of an IPO through book-building was removed and all companies were allowed to make issue through book-building. However, if the track record criteria is satisfied, allocation to QIBs can be less than 60 per cent.

### **Book-building**

In order to further strengthen the book-building process in the light of the experience gained from the recent issues through book-building, the following amendments to the book-building guidelines were issued by the SEBI in addition to the requirement already laid down. These amendments will help further to rationalise the existing provisions of book-building guidelines and introduce greater transparency in the price discovery process.

#### **Box 1.2 : Streamlining guidelines for book-building**

- 100 per cent one stage book-building has been permitted with bidding centres at all cities with stock exchanges.
- The present provision of allowing 75 per cent of the issue to be offered through book-building would continue. The fixed price issue portion applicable for the balance 25 per cent of the issue will continue to be available to individual investors applying for upto 1000 shares.
- The allocation of 100 per cent book building will be as follows :
  - a. Not more than 60 per cent of the book built portion will be allocated to institutional investors i.e. Banks,

*(contd. on next page)*

*(contd. from previous page)*

FIIIs, Mutual Funds and other Financial Institutions as defined in Section 4A of the Companies Act, on a discretionary basis. The maximum bid by these categories is restricted to the investment limit prescribed in the respective Regulations/Guidelines as applicable to these institutions.

- b. These changes are to the advantage of individual investors as the scope of discretionary allocation to the institutional investors would get reduced.
  - c. At least 15 per cent of the book-built portion of shares would be distributed on proportionate basis to non-institutional investors applying for more than 1000 shares.
  - d. The remaining 25 per cent of the shares would be available to the small investors to be allocated on pro-rata basis.
- On-line-display shall be mandatory for all issues through book-building. Data entry of bids shall be on a real time basis. Availability of information about the demand at different price levels would thus be assured to facilitate genuine price discovery.
  - Uniform margin shall be collected from non-institutional and individual investors if any.
  - The price band under the prevailing system has resulted in bidding only at the upper end and has effected proper price discovery. Only the floor price will now be required to be disclosed as an indicative price.
  - Names of all book runners would be allowed to be mentioned on the front cover page to enhance transparency in the book building process, price determination and allocation.

#### ***Promoter's contribution and lock-in of pre-IPO share capital***

- SEBI has in place provisions relating to lock-in-period for promoter's contribution. In addition, there were different lock-in requirements for unlisted companies which made issues at a price below the IPO price. In order to streamline the provisions and to ensure that pre-IPO investors of the company do not take an entry and price advantage, SEBI has mandated that in case of unlisted companies, the minimum promoters contribution of 20 per cent shall be locked in for 3 years and the balance of the entire pre-IPO capital, shall be locked in for 1 year from the date of commencement of commercial production or the date of allotment in the public issue, whichever is later. The entire pre-issue share capital shall be locked-in except which is held by Venture Capital Funds and Foreign Venture Capital Investors registered with the SEBI. However, there would be a lock-in, if applicable as per the provisions of the SEBI (Venture Capital Funds) Regulations, 1996 and any amendment thereto and the SEBI (Foreign Venture Capital Investors) Regulations, 2000. The stipulation for lock-in of pre-issue share capital would ensure that the promoters and associates remain committed to the company and do not use the public issue and subsequent listing of the company's shares as an exit route. The SEBI has also stipulated that all firm allotments shall be locked in for a period of one year
- It was also been provided that promoters contribution is required to be kept in escrow account with a scheduled commercial bank and the same can be released only with the public issue proceeds. This requirement ensures the same treatment for promoters contribution as is prescribed currently in respect of application monies received from public issues.

#### ***Disclosure requirements enhanced***

- During 2000-01, the SEBI prescribed enhanced disclosure requirements to be made by companies in offer documents requiring the issuer companies to disclose the details of utilised

and unutilised monies received under promoters' contribution, firm allotments and reservations in their balance sheet. Companies are now required to indicate the purpose for which such monies were utilised and also state the form in which such unutilised monies have been invested. These requirements have also been specified in case of monies accrued to the company as a result of a preferential issue.

- In case the promoters' contribution, which was brought prior to the public issue and has already been deployed by the company, it was stipulated that the issuer companies are required to give the cash flow statement in the offer document disclosing the use of such funds.
- To address apprehensions about disclosure of overly optimistic future performance by the company, the SEBI prohibited issuer companies from giving any forecast or projections relating to their financial performance in their offer documents.
- The issuer companies and their lead merchant bankers are required to provide justification for the issue price and no lead manager can proceed with the issue in case the accounting ratios do not justify the issue price. In case of book-built issues, it should be stated that the final price has been determined on the basis of the demand from the QIBs.

#### ***Reduction in time taken for completion of formalities relating to allotment, despatch of certificates and listing***

SEBI has also reviewed the procedure regarding the time frame for completion of allotment of shares and subsequent listing of public issues as well as book-built issues. The time for finalising the allotment has been reduced from 30 to 15 days in book-built issues. Therefore, the issue process would be completed faster and risks associated with volatile markets is expected to be minimised. In order to ensure that investors get the shares/refunds earlier than the present minimum period of 30 days, it has also been stipulated that the despatch of share certificates/ refund orders/ cancelled stock invests and demat credits is completed within 2 working days of finalisation of basis of allotment. Further, the SEBI has stipulated that listing and trading of shares allotted in the public issue should be done within 7 working days of finalisation of basis of allotment, thereby giving the investors an early exit.

The SEBI has stipulated that the lead merchant banker should obtain from the stock exchange where the securities are proposed to be listed, in-principle an approval for listing of the securities, within 15 days of filing of the draft offer document with the stock exchanges. The same should then be furnished to SEBI. This would rationalise the listing procedures and also enable listing and trading of securities within 7 days from the date of allotment.

#### ***Preferential allotment disclosures and lock-in***

The guidelines on preferential allotment were modified to provide for additional disclosures in the explanatory statement to the notice for the general meeting in terms of Section 173 of Companies Act, 1956. It was stipulated that the notice shall state the objective of the issue

through preferential offer, intention of promoters/directors/key management persons to subscribe to the offer, shareholding pattern before and after the offer, proposed time within which the allotment shall be complete and the identity of the proposed allottees and the percentage of post preferential issue capital that may be held by them. The aforesaid stipulation would enable the shareholders to have adequate information regarding the allotment on the basis of which they can accord their approval to the allotment. In the absence of such disclosures, in the past, shareholders routinely approved resolutions without knowing the purpose of allotment, the identity of the allottees and other price-sensitive information that would have had a bearing on them indirectly.

In addition to the prevailing requirements for lock-in of instruments allotted on preferential basis to promoters/promoter group, the SEBI has prescribed that instruments allotted on preferential basis to any person including promoters/promoter group shall be locked-in for a period of one year from the date of their allotment except for such allotments which involve share swap for acquisition.

### ***Compulsory trading in dematerialised form***

The SEBI has stipulated that the trading for all IPOs would compulsorily be in dematerialised form, though investors could opt to apply for and get physical shares. Therefore, investors are induced to opt for demat credit of allotments. This would ensure that the shares are already with the investor before listing and trading commences and problems with loss of allotment letters, share certificates are done away with.

### ***Unsecured debt instruments of maturity less than 18 months***

According to the earlier guidelines, debt instruments with maturity over 18 months were compulsorily to be secured. In order to provide a variety of debt instruments and to help the development of the debt market, the SEBI permitted the issue of unsecured/ sub-ordinated debt instruments for providing mezzanine capital provided that these are subscribed by QIBs or where the debenture allottees/holders have given their positive consent.

### ***Guidelines for offering securities in public issues through the stock exchange mechanism***

In order to simplify issue procedures, reduce issue costs as well as reduce the time taken in public issues, the SEBI issued guidelines permitting companies to offer securities in public issues through the stock exchange mechanism. Issuer companies now have the option of issuing securities through the on-line-system of the stock exchange or through the existing banking channel. In this system, brokers would place 'buy' orders for shares in the primary issue on behalf of their clients. The brokers would transfer the valid order data to the registrars to the issue on a daily basis. On closure of the issue, the basis of allocation would be finalised after which brokers would intimate the fact of allocation and allocation money payable to their client. On receiving the money, the broker would hand over the application forms and monies to the exchange after adjusting for any margin money previously collected. On completion of the above, the company would allot shares to the applicants. The system envisages that allotment of securities should be made not later than 15 days from the closure of the issue.

### **Recommendations of the working group on multiple applications**

A working group was set up by the SEBI, under the chairmanship of Prof. J.R. Varma, full-time member, to recommend methods to tackle the problems due to multiple applications and make recommendations for modifications in market practices and procedures relating to public issues for improving the transparency and fairness in the capital market. The Group submitted its report. The SEBI Board considered the report and accepted all its recommendations. Some of the important recommendations are given in Box 1.3.

#### **Box 1.3: Recommendations of the Working Group on Multiple Applications**

- Multiple applications in an issue would be permitted subject to the applicant declaring in all his application forms except the first form, that he is making multiple applications and identify all such applications. All these applications (in single name as well as joint names) would be clubbed and will be considered in the higher category (>10 market lots) and therefore be subject to smaller proportion of allotment while finalising the basis of allotment. In case of wrong/false declaration by the applicant to this effect, all his applications would be compulsorily rejected and the applications monies would be refunded. Actual allocation of shares to each applicant would be made on a pro-rata basis.
- A uniform minimum standard procedure would be used by all registrars to an issue for the purpose of detection of multiple applications.
- Disclosure of the full names in the application forms should be made compulsory by investors to facilitate easy detection of multiple applications.
- All suspicious and fictitious applications should be detected. The allotments on these applications would be completed in the same manner as that for normal applications but the despatch of share certificates/ credit to demat account in respect of these 'fictitious' applications would be frozen until such time that the identity and genuineness of the applicant is established. Only after satisfactory verification of the genuineness of the applicant, the shares would be credited/ released to the allottee.
- During the period for which the shares are 'frozen', the investors would be given an option to sell the shares kept in abeyance if they so desire. However, the proceeds of such sale would remain frozen and would be released only after the completion of verification and identification of the applicants. In case the applicants are not genuine, the proceeds of the sale of shares would go to the Investor Protection Fund.
- Compliance with the above process is to be ensured by the issuer/ merchant banker/registrar to the issue irrespective of the level of subscription of the issue. The group recommends that prosecutions under Section 68A of the Companies Act shall also be initiated against the fictitious applicants wherever found appropriate.
- Additionally, the group recommends that as the powers under Section 68A of the Companies Act have now been delegated to SEBI, the instances of fictitious applications noticed shall be scrutinised and prosecution proceedings shall be initiated by the SEBI. This is with a view to prevent further occurrence of fictitious applications and also to enforce actions against the fictitious applicants.
- The present system of allotment in market lots would be done away with. There would be a simple proportionate allotment to the applicants in the respective categories. However, to prevent fractional allotments and allotments of miniscule value, the minimum allotment should be higher of the following :
  - a) one share or
  - b) smallest integral number of shares that have a value of Rs. 1000/- calculated on the basis of issue price.
- Application forms for new issues can be made available through alternative sources of supply of applications such as through internet, newspaper, photocopies in addition to the present system of pre-printed applications
- In case of issues, where the issue size is less than Rs. 10 crore, the investor shall have the option of receiving share certificates in dematerialised or physical form, as permitted under Section 68B of the Companies (Amendment) Act, 2000. If the investor chooses that the share certificate needs to be issued in form of physical certificates, he has the option of receiving the same in market lots or as one jumbo certificate.

*(contd. on next page)*



*(contd. from previous page)*

- The requirement of pre-numbering of applications forms issued through other sources (i.e. other than the present system of pre-printed application forms) would not be necessary and application numbers would be assigned by the collecting banker and/ or registrar at the time of acceptance of applications.
- All advertisements in newspapers featuring application forms of issues shall contain the abridged prospectus in order to enable prospective investors to read the prospectus and the application form before making an investment decision. On the website also the application forms shall be posted along with the contents of the abridged prospectus. Further, it was suggested that the application forms may be downloaded only after the user has downloaded the abridged offer document and clicked on a button signifying that he has done so and that he accepts the obligation not to distribute the form without the accompanying abridged offer document. The downloaded application form shall also bear a legend that it is illegal to distribute the form without the abridged offer document.

### ***Listing of debt before equity***

SEBI permitted all companies to issue debt securities to the public without listing equity subject to fulfilling certain conditions, to help infrastructure companies who may raise resources from the market through debt instruments.

### ***Malegam committee***

The Standing Malegam Committee on Disclosure Requirements under the chairmanship of Shri Y H Malegam held a number of meetings during the year 2000-01. The committee reviewed the present disclosure requirements for public and rights issues and suggested modifications to them. The suggestions of the Committee were considered by the SEBI. Some of the suggestions were implemented and the remaining are under implementation. Further, the Committee discussed certain issues such as disallowing issues by companies involving persons having questionable track record, listing of risk factors in order of their criticality, branding of issues etc. Deliberations are under progress.

## **ii. Secondary Securities Market**

### ***Corporate governance***

Strong corporate governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. The development of capital market is dependent on good corporate governance without which investors do not repose the confidence in the companies. The committee on corporate governance set up by the SEBI under the chairmanship of Shri Kumar Mangalam Birla, member SEBI Board with the objective of strengthening and promoting the standard of corporate governance of listed companies, had made several recommendations.

This is the first formal code of corporate governance in the country implemented through the listing agreement entered into by the companies with the stock exchanges. It is expected that the introduction of these measures will raise the awareness and make a good beginning for raising the standard of functioning of corporates. The SEBI board accepted the recommendations of the committee.

The recommendations of Kumar Mangalam Birla Committee for listed companies are mandatory and non-mandatory. The mandatory recommendations have been enforced on the listed companies for initial and continuing disclosures in a phased manner within specified dates, through the listing agreement. The non-mandatory recommendations would be implemented by the companies voluntarily. However, these companies are required to disclose the compliance with non-mandatory requirement. The SEBI has also written letters to RBI and other relevant authorities to consider the recommendations of the committee while issuing guidelines to entities under their jurisdiction. The SEBI has also written letters to financial institutions, chambers of commerce and other entities to observe the recommendations contained in the report that would help in raising the standards of corporate governance.

With a view to ensure compliance with the provisions of corporate governance in the listing agreement of the stock exchanges, the SEBI issued guidelines to stock exchanges that they will be required to set up separate monitoring cells with identified personnel. The companies, which are scheduled in the first phase, will be required to submit a quarterly compliance report to the stock exchanges.

The SEBI has also stipulated that all the IPOs seeking listing for the first time will be required to comply with corporate governance provisions at the time of listing, except in cases where there are genuine legal issues. The stock exchanges must ensure that these have been complied with before granting listing. For this purpose, it will be enough if these companies have set up the Boards and constituted the committees such as audit committee, shareholder grievance committee etc., before seeking listing. In addition, the lead merchant bankers will also be required to incorporate the compliance as a part of the 'Due Diligence Certificate' submitted to SEBI. In case of companies failing to comply with this requirement, the application money will be kept in an escrow account till compliance.

### *Stringent financial disclosures*

SEBI has introduced stringent financial disclosure norms for the listed entities. Some of the disclosure norms are as follows:

- With a view to make the unaudited financial quarterly results of the companies more transparent and meaningful, certain additional disclosure norms have been prescribed and also half yearly results have been subjected to a 'Limited Review' by the Auditors with effect from half year ending March 31, 2000.
- The Cash Flow Statement as per the Listing Agreement required to be mandatorily prepared in accordance with the relevant Accounting Standard.
- Disclosures on materially significant related party transactions i.e. transactions of the company of material nature, with its promoters, the directors or the management, their subsidiaries or relatives etc. that may have potential conflict with the interests of company at large.
- Details of non-compliance of penalties, strictures imposed on the company by Stock Exchange or SEBI or any statutory authority, on any matter related to capital markets, during the last three years.

### *Accounting standards committee*

The Accounting Standards Committee, was set up by the SEBI as Standing Committee under the Chairmanship of Shri Y H Malegam, to inter-alia review the continuous disclosures requirements under the listing agreement for the listed companies and provide inputs to Institute of Chartered Accountants of India (ICAI) for evolving new accounting standards and review the existing ones, wherever required in order to make disclosure standards and accounting practices at par with the international practices.

Major recommendations of the Committee that have been implemented by the SEBI are given below:

- Based on the recommendation of the Secondary Market Advisory Committee regarding corporate announcements under Clause 20 and 22 of the Listing Agreement, it has been prescribed that
  - the company shall immediately disclose all material information simultaneously to all the Stock Exchanges where the securities of the company are listed.
  - in respect of the any material events arising out of decisions taken in the Board Meetings including the announcements of results, dividends, bonus, rights etc, the information shall be furnished to the stock exchanges within 15 minutes of the closure of the Board Meetings.
  - the Regional Stock Exchange of the listed company shall disseminate the information to all other stock exchanges where the securities of the company are listed or traded.
- In order to improve the reliability of the information provided to the investors, it has been prescribed that companies shall have an option to publish audited half yearly financial results within two months instead of publishing unaudited results within one month followed by a Limited Review within two months.
- Considering the recommendation of Reserve Bank of India (RBI), a separate format for reporting of quarterly/half yearly results and review reports for the listed banks has been prescribed.
- With a view to provide information to the investors regarding usage of the funds, it has been prescribed that the companies which are yet to commence commercial production, shall make additional disclosures as prescribed under schedule VI of the Companies Act, for the balance of unutilized monies raised by issue and the form in which such unutilized funds have been invested, on quarterly basis.
- The Committee has recommended that in order to significantly increase the disclosures of financial information by the companies, ICAI may issue Accounting Standards on Segmental Reporting, Related Party Transactions, Consolidation of Accounts, Deferred Taxes and Earning Per Share. ICAI has issued Accounting Standards on the above subject.

### ***Sub-Committee on dot com companies***

In the light of concern for investor protection in the era of new economy highlighted by the SEBI at the IOSCO's Annual Conference, the Accounting Standards Committee constituted a Sub-Committee to:

- examine and recommend additional disclosure requirements to be made in offer documents of dot-com companies with the objective of providing sufficient information, both financial and non-financial, to potential investors to enable them to understand the business model of the dot-com companies and determine their fair value.
- examine and recommend initial and continuous disclosure requirements for dot-com companies including disclosures in their financial statements.
- prescribe accounting and financial reporting guidance to be adopted by dot-com companies and to identify and define critical items emerging due to the unique nature of business of dot-com companies (such as the definition of revenue, principles of revenue recognition, treatment of expenses as pre-paid or intangible assets as opposed to their recognition as period costs, etc).

### **Meeting of the Secondary Market Advisory Committee**

The Secondary Markets Advisory Committee (SMAC) met on November 28, 2000 which discussed the state of the capital market and suggested measures for the improvement in the functioning of the stock exchanges. Shri S. S. Tarapore, former Dy. Governor, Reserve Bank of India was the Chairman of the Committee. The major recommendations of the Committee were on abolition of no-delivery period, reduction in period between two book closures, use of digital signature on contract notes, uniform client code, disclosure of material event, minimum floating stock requirement for continuous listing, relationship between broker and sub broker, know your client, model code for registrars and IPOs through Secondary Market Route. These recommendations have already been implemented.

### **Other measures to strengthen Securities Market**

SEBI convened a meeting of the all the stock exchanges on January 17, 2001 and took the following decisions:

#### ***Distribution of share holding***

To bring about greater transparency in respect of disclosure of shareholding pattern of companies, the listed companies will be required to disclose the shareholding pattern on a quarterly basis within 15 days of end of the quarter in a format to be specified by the SEBI. This disclosure will also include, disclosure in respect of all entities in the promoter group - individual or body corporates. Besides, names of all persons who have one percent shareholding will also be disclosed. The foreign holdings and GDR and ADR holdings will be disclosed separately.

#### **Conditions for continuous listing**

Currently there is no regulatory requirement to maintain a minimum floating stock post listing on a continuous basis. The SEBI issued the following policy provisions for continuous listing

as a measure of investor protection as it would ensure availability of floating stock on a continuous basis. Henceforth there will be a requirement for all listed companies to maintain a minimum level of non-promoter holding on a continuous basis as a condition for listing.

- All new companies shall be required to maintain on a continuous basis the non-promoter holding at the same level as applicable at the point of entry (i.e. 10 per cent or 25 per cent). For existing listed companies, where the non promoter holdings is less than the applicable limit at the point of entry, the companies will be given time upto one year to raise the level of non-promoter holding to at least 10 per cent. In case they fail to do so, they will be required to buy out the public shareholding in a manner similar to that provided in the SEBI (Substantial Acquisitions and Takeovers) Regulations.
- No preferential allotment/ buy back of listed companies would be permitted if as non promoter holding falls below the ceilings permitted under the SEBI (DIP) guidelines applicable at the point of entry.
- None of the above conditions will apply to BIFR companies.
- The stock exchanges will monitor the level of non- promoter holding on a half-yearly basis from the returns to be submitted by companies in specified formats. The non-promoter holding will also be disclosed half yearly as part of half-yearly disclosures by the companies.

### **Rolling settlement**

The SEBI has been committed for introduction of rolling settlement on Indian bourses. Rolling Settlement avoids the trade processing congestion, improves operational efficiency and reduces risk in the system. The rolling settlement was introduced on experimental basis for 10 scrips and thereafter more scrips were added to it taking to a total of 163 scrips under rolling settlement in the non-specified group. Following the announcement made by the government in the parliament, the scope of rolling settlement was expanded. All scrips included in the ALBM / BLESS or MCFS which were required to be traded only in the compulsory rolling settlement on a nation wide basis from July 2, 2001. This measure was taken pursuant to the announcement made by the government in the parliament. In addition if there was any scrip included in the BSE 200 list but not covered by the above list will also be included in the compulsory rolling settlement. With that expansion on March 20, 2001 that rolling settlement covered an additional number of 251 scrips to be traded compulsorily in rolling settlement from July 2, 2001 thus bringing the total number of scrips on rolling settlement to 414 by that date. The facility of deferral products namely ALBM /BLESS or MCFS also ceased to be available from that date for all scrips except as a transitional measure only for the purpose of liquidating outstanding positions by September 3, 2001.

### **Introduction of automated lending and borrowing mechanism**

The SEBI constituted a working Group under the chairmanship of Prof. J R Varma, Member, SEBI Board to discuss various issues related to Automated Lending and Borrowing Mechanism

(ALBM). The Risk Management Group constituted by the SEBI also discussed these issues. Based on their recommendations of these Groups, following decisions were taken :

- It was decided that ALBM would be permitted as a generic product. The basic purpose of ALBM would be to facilitate lending and borrowing of securities as envisaged by the Stock Lending Scheme 1997 (SLS). The ALBM however may also serve the purpose of deferral of settlement by netting off obligations in ALBM with obligations in the normal settlement. This would result in carrying forward of the positions in the normal settlement as in the case of Modified Carry Forward System.
- An Exchange would be eligible to introduce the ALBM if it satisfies the following conditions:
  - i. The exchange must demonstrate that it has a well-designed software for margin computation and well established governance structures and administrative infrastructure for monitoring and enforcing the margining system. If necessary, an inspection of the exchange would be carried out by SEBI to satisfy itself about the adequacy of its margining system.
  - ii. The exchange or its clearing corporation must be an approved intermediary under the stock lending scheme.
- Exchanges desirous of implementing ALBM will obtain SEBI approval for :
  - i. The eligibility criteria for scrips to be included in the ALBM list
  - ii. The process of choosing the scrips in the ALBM list
  - iii. Disclosure and transparency provisions relating to the above

#### *Position Limits*

There will be a position limit per broker of Rs.40 crores in the aggregate and Rs 5 crores per scrip. These limits will be determined on the basis of gross position for the broker. These limits would apply only to trade positions that are netted against ALBM positions, and would not apply to stand-alone ALBM positions. However, the positions of pure securities borrowers, who would be withdrawing the shares would be included in the above mentioned overall position limit of Rs.40 crores in aggregate and Rs.5 crores per scrip.

#### *Short Sale Transactions*

A short seller receives charges in the ALBM when the lending price is below the clearing price. Such charges shall be released to the short seller only if either the seller actually owns the shares (and is using ALBM only for operational convenience or other reasons) or the seller actually has funds by which he could have taken delivery of the borrowed shares even if the ALBM transactions and trade transactions were not netted off. In other cases, the excess of the clearing price over the lending price would be credited to the Investor Protection Fund of the Exchange and shall not be released to the short sellers.



*Margins*

*Margining on Gross Basis* : ALBM transactions, which are netted against trade positions, would be subjected to margining on the basis of gross positions i.e. positions grossed across clients.

*ALBM Margin* : The margin on all trade positions that are proposed to be netted against ALBM transactions shall not be less than 10 per cent. Further, in cases where the position so netted by a member exceeds Rs 20 crores, the excess over Rs 20 crores shall attract a margin which shall be at least 15 per cent (5 per cent above the 10 per cent limit).

The minimum ALBM margins would start applying only at the end of the ALBM session, as because of the very nature of the product it would be difficult to achieve the segregation of twin track in the case of ALBM as in the case of carry forward system.

*Incremental ALBM Margin* : In case the gross position in ALBM in any exchange, in any scrip, exceeds the parameters mentioned below, the additional margin shall be levied, in addition to the ALBM margin, at a rate which is higher of the rates determined as per the tables below :

<b>Gross Outstanding Market Position (Rs. in crores)</b>	<b>Rate of Margin</b>	<b>Deferred Gross Positions in ALBM (in number of shares as % of total number of shares paid up)</b>	<b>Rate of Margin</b>
Exceeding 75 and up to 100	5%	Exceeding 3% going upto 4%	5%
Exceeding 100 and up to 150	8%	Exceeding 4% going upto 5%	8%
Exceeding 150 and up to 200	12%	Exceeding 5% going upto 6%	12%
Exceeding 200 and up to 300	17%	Exceeding 6% going upto 7%	17%
Exceeding 300 and up to 400	23%	Exceeding 7% going upto 8%	23%
Exceeding 400	30%	Exceeding 8%	30%

The positions shown above exclude the positions pertaining to the pure securities borrowers to the extent that the collateral securities are kept with the clearing house/corporation. Once this margin is imposed by any exchange having ALBM or MCFS facility, the other exchanges having ALBM or MCFS will also follow the same from the start of next settlement.

*Collection of Margins* : These margins would be paid 100 per cent in cash or fixed deposits or government securities, or a combination of three. Mark to market margin shall be collected separately from daily/exposure margin, as the purpose of the two margins is different. Risk management of pure securities borrowers' obligations to return securities. Pure securities borrower means a borrower of securities who does not have an offsetting long trade position.

Pure securities borrowers will have the option of depositing the collateral with the clearing corporation. A pure securities borrower who does so would not be subjected to any margin.

However, if at the end of the settlement, the pure securities borrower wishes to initiate a fresh transaction to continue the pure borrowing of securities for one more week, mark to market margin would be imposed at that stage. The pure securities borrower who opt for withdrawing the shares from the clearing house/clearing corporation shall be subject to margins such as mark to market margin, exposure margin etc. in addition to ALBM margins. The stock exchanges would be allowed to introduce ALBM after satisfying the conditions and modalities detailed above and after seeking formal approval from SEBI in this regard.

### *Carry forward, automated lending and borrowing and continuous net settlement in the rolling settlement*

The SEBI in its meeting held on June 14, 2000 had considered and approved the proposals for the carry forward and the continuous net settlement system in the rolling settlement. Later on, a meeting of the stock exchanges having facilities of carry forward and automated lending and borrowing was held on August 23, 2000 to discuss the preparedness of the stock exchanges for the introduction of carry forward, ALBM and the continuous net settlement in the rolling settlement, the features of which are given below:

#### *Carry forward under rolling settlement (CFRS)*

It was decided that there would be carry forward session at the end of each trading day and, the investor would have a choice of carrying forward a position for 1, 2, 3, 4 or 5 trading days. There would be separate screens where bids and offers could be posted for each of these five variants. During the term of a carry forward for greater than 1 day the investor may square off the carry forward position. In such a case, the investor would first have to square-off the position in the market by carrying out appropriate buy/sell transaction and then do a contra carry forward for the remaining period of the carry forward. e.g. an investor who carries forward for one week (5 trading days) today, would be able to square off tomorrow by taking an offsetting position tomorrow and carrying it forward in the four day carry forward market.

#### *Automated lending and borrowing under rolling settlement (ALBRS)*

The ALBM session would be held everyday and would involve lending and borrowing for 1, 2, 3, 4 or 5 working days. The separate screens will provide the facility for lending/borrowing for these five variants. Thus, for the ALBM session held on day T the first leg will be settled on T+5 day. For a one-day tenure lending, the reverse leg will be created on T+1 day and will be settled on T+6 day. Similarly, in case of a 2 day tenure lending, the reverse leg will be created on T+2 day and will be settled on T+7 day and so on.

#### *Continuous net settlement (CNS)*

Internationally, the CNS has been effectively employed by the clearing corporations for the settlement of transactions and for maintaining an orderly flow of money and securities. The

CNS is carried out by the Clearing Corporation / Clearing House as a post settlement processing whereby, the seller who has failed to deliver securities can postpone the settlement of his obligations to the subsequent settlement. This is primarily a tool for imparting flexibility to the seller.

The key features of the CNS are as under :

- The CNS would be available only in the Compulsory Rolling Settlement segment.
- CNS is essentially post settlement processing.
- The CNS is delivery initiated.
- In the CNS process, the short deliveries of the seller are marked to the closing price of the day and the corresponding amount is debited to the delivering member.
- The settlement of the CNS positions is postponed to subsequent settlement.
- Since the CNS is a post settlement activity, the receiving member has to necessarily fulfil his funds pay-in obligation. The receiving member however would be subsequently credited for the value of the deliveries to the extent that he has received short.
- The receiving member has the option of insisting on delivery. The members can indicate the preference for compulsory receipt of delivery in which case it will be given higher priority for delivery receipt. In the event of failure to deliver shares to such receiving members, these positions would be removed from the CNS and subjected to compulsory delivery. Compulsory buy-in or close-out would be effected in the event of failure to deliver.

#### *Eligibility of stock exchanges*

The exchanges which have already implemented the MCFS or Automated Lending and Borrowing Mechanism (ALBM) as prescribed by SEBI in account period settlement would be eligible to implement CFRS and ALBRS respectively. The other exchanges would seek the prior permission of SEBI for introduction of CFRS or ALBRS. The exchanges would have to seek prior permission of SEBI for the introduction of CNS. For obtaining such permissions the exchange must demonstrate that it has a well designed software, well established governance structure and administrative infrastructure for monitoring and enforcing the margining system and surveillance capability. If necessary, an inspection of the exchange would be carried out by the SEBI to satisfy itself.

#### *Eligibility of scrips*

The criteria for scrips eligible for these products would be issued separately.

#### *Risk containment measures*

Risk containment measures for these products would also be issued separately. Subsequently, while expanding the list of rolling settlement to 414 scrips, and removing the availability of all deferral products from July 2, 2001, it was decided to defer the introduction of CNS.

### Setting up of trade/settlement guarantee fund by stock exchanges

In June 1997, the SEBI issued guidelines for setting up Settlement Guarantee Fund (SGF) by the stock exchanges, and prescribed that in the event of a failure of member/s to honour their settlement commitment, the SGF will fulfill the commitment only after declaring the member/s as defaulter/s and such member/s would not be eligible to continue to trade, and default proceedings as per the bye-laws of the exchange would have to be initiated against him.

The stock exchanges were allowed to utilise the SGF maintained by them for meeting the shortages arising out of non-fulfillment/partial fulfillment of the funds obligations by the members in a settlement before declaring the concerned member defaulter in the same manner as in the case of NSCCL. Towards this end, the bye-laws would be suitably amended and norms for utilisation of SGF would have to be prescribed. The bye-laws were amended on the following lines.

*“In the event a member fails to meet obligations to the clearing house of the exchange arising out of clearing and settlement operations of such deals as provided in the Bye-laws and Regulations, the relevant authority may utilise the settlement guarantee fund and other monies to the extent necessary to fulfill the obligation under such terms and conditions as the relevant authority may specify from time to time.”*

The following norms for utilisation of full SGF were also laid down :

- The settlement guarantee fund maintained by the exchange, may be utilised for meeting the shortages arising out of non-fulfillment/partial fulfillment of the funds obligations by the members in a settlement before declaring the concerned member defaulter subject to the following:
- In cases where amount shortages are in excess of the base minimum capital (BMC) prescribed, the trading facility of the member is withdrawn and the securities pay-out due to the member is withheld. In cases where the amount of shortages exceed 20 per cent of the BMC and is less than the BMC on six occasions within a period of three months, the trading facility of the member is withdrawn and the securities pay-out due to the member is withheld. On recovery of the complete shortages, the member is permitted to trade with a reduced gross exposure as indicated in the table below:

<b>Cumulative Funds Shortage</b>	<b>Exposure limit allowed (%of current exposure limit)</b>
20% of BMC – 50% of BMC	80%
50% of BMC – 100% of BMC	60%

- This reduced gross exposure level is maintained for a period of four settlements. If the cumulative funds shortage for the next 4 settlements is less than 20 per cent of BMC, the exposure limits shall be restored. The exposure limit may be restored if a member provides a cash deposit equivalent to his cumulative funds shortages as the ‘funds shortage collateral’ in his clearing account. Such deposit will be kept with the exchange for a period of 4

settlements and will be released only if no further funds shortages are reported for the member in next 4 consecutive settlements. There is neither exposure benefit nor any interest payment on this amount so deposited as 'funds shortage collateral'. Members may deposit the 'funds shortage collateral' by way of cash, FDR or Bank Guarantee.

- The outstanding amount would carry a penal interest of not less than 0.09 per cent per day.

According to information available with SEBI, 11 settlement guarantee funds were in operation as on 31.3.2001. Details of funds in operation are provided in Table 1.4.

**Table 1.4 : Stock exchange-wise SGF Details**

S.No.	Name of Stock Exchange	SGF Schemes Operational as on 31.3.2001
1.	Bombay	May 12, 1997
2.	Ludhiana	February 27, 1998
3.	Bangalore	January 23, 1998
4.	Calcutta	March 10, 1998
5.	Delhi	April 03, 1998
6.	Vadodara	August 04, 1998
7.	Madras	August 21, 1998
8.	OTCEI	October 09, 1998
9.	ICSEIL	January 06, 1999
10.	Ahmedabad	February 02, 1999
11.	Hyderabad	July 09, 1999

Source : NSE Clearing Corporation.

### *Scrip-wise price bands*

To contain abnormal price variations, SEBI had earlier introduced the system of scrip specific daily price bands. The system of price bands was fine-tuned and further variation of 8 per cent was allowed in the scrip price beyond the existing limit of 8 per cent after a cooling-off period of 30 minutes. This measure has provided additional exit route to investors. This modification was made applicable in the top 200 scrips, identified jointly by BSE and NSE.

### *Code of ethics for directors and functionaries of exchanges*

The 'Code of Ethics' for directors and functionaries of the stock exchanges, aimed at improving the professional and ethical standards in the functioning of exchanges thereby creating better investor confidence in the integrity of the market, was approved by the SEBI Board.

The code of ethics is based on the fundamental principles of fairness and transparency in functioning of exchange, avoidance of conflict of interest in decision making, and compliance with all laws/ rules/ regulations laid down by regulatory agencies/ exchanges and exercising due diligence in the performance of duties. The code of ethics requires stock exchanges to form

an ethics committee to oversee implementation of the code and provides, among other things, for the following:

- a) Disclosure of dealings in securities by functionaries and directors of the exchange - transactions by functionaries of the exchange should be of an investment nature and should be held for a minimum period of 60 days.
- b) Prohibition on dealings in securities in proprietary account by elected office bearers - president, vice president and treasurer of an exchange shall refrain from proprietary trades in securities.
- c) Disclosures of beneficial interest of functionaries and directors of the exchange
- d) The president and directors shall not interfere in the day to day functioning of the exchange and shall limit their role to decision making on policy issues and to issues as the Governing Board may decide.
- e) There should be prescribed channels through which information shall move and there should be audit trail of the same.

### *Trading in unlisted securities*

The OTCEI was permitted to develop a trading window for unlisted securities where QIBs including venture capital funds/foreign venture capital investors would be permitted to participate.

### *Depositories and paperless trading and other related issues*

Dematerialisation of securities is one of the major steps for improving and modernising market and enhancing the level of investor protection through elimination of bad deliveries, forgery of shares and expediting the transfer of shares. Recognizing the far reaching benefits that would accrue to the market through the removal of physical securities, the speeding up of dematerialisation process has been high on the agenda of the SEBI. During the year 2000-01 also, the SEBI continued its policy to enhance the growth of paperless trading and electronic book entry transfer but in a phased manner so as to allow time for required infrastructure to develop and to gain acceptance of the investors and the market. The SEBI constantly reviewed the safeguards in the system and took steps to enhance safety of the system so as to better protect the interest of investors and to streamline the procedures. These measures were taken by the SEBI in consultation with the depositories, stock exchanges and the users of the system after obtaining feedback of the investors. The following measures have been taken by the SEBI during the year under review:

- The SEBI issued directive to the companies included in the list of securities for dematerialisation to effect compulsory dematerialised trading for all investors on the scheduled dates announced and to sign agreements and complete all formalities with both the depositories and establish connectivity on time so that dematerialisation could proceed on schedule.
- Further to address the problem of delay in dematerialisation of shares just before the scheduled date for compulsory dematerialised trading for all investors, it was decided that the date



already announced by the SEBI shall henceforth be treated as the date for establishing connectivity with the depositories, and compulsory trading in dematerialised form for all investors shall commence three months hence.

- Companies which fail to sign the agreement and establish connectivity with the depositories within the stipulated time, the shares of such companies shall be traded only on “trade for trade settlement” window of the exchanges from that date.
- Companies whose shares are being traded compulsorily in dematerialised form by all investors, are required to compulsorily provide for simultaneously transfer and dematerialisation of securities. The time given to the investor to submit the authority letter to the participant for dematerialisation was increased from fifteen days to one month, to take care of the postal delay.
- The SEBI had meetings at periodical intervals, with companies whose names figure in the list of top 25 companies unduly delaying dematerialisation of shares forwarded by the depositories. These companies have been advised to reduce the balances of pending demat requests within a week and report compliance to the depositories.
- The SEBI also allowed the stock exchanges themselves to announce up to 150 scrips other than the scrips announced by the SEBI, for compulsory dematerialized trading by all investors. This would help the exchanges to identify and announce the list of scrips not included in the SEBI list to be traded compulsorily in dematerialised form by all investors.
- A Standing Committee co-chaired by the Managing Directors of NSDL and CDSL was formed to meet at least once a month to resolve issues between DPs, registrars and depositories which may arise from time to time. The other members of the committee are SHCIL, HDFC Bank, Standard Chartered Bank, Integrated Enterprises (I) Ltd., Karvy Consultants, ICICI Ltd. and representative from RAIN.
- CDSL and NSDL were required to persuade major DPs to open branches in cities where DP services are not available.
- The ‘No Delivery Period’ on account of book closure/record dates for corporate actions such as issue of dividend and bonus shares in respect of the scrips, which are traded in the compulsory, dematerialised mode was also abolished. The present system of ‘No Delivery Period’ on account of book closure/record date for the rights issues, will continue.
- Inspection of depository participants of NSDL and CDSL was carried out during the year. In the light of the findings of inspection, the importance of exercising utmost care and caution in the opening of beneficiary owner’s accounts and diligently following the instructions laid down for the purpose in the SEBI circulars was stressed upon the depository participants. These are critical steps for the safety, integrity and efficient functioning of the depository system.
- The SEBI also advised both the depositories to put safeguards in place to protect the interest of the investors against any possible misuse of the pool account balances. To further address the issue of pool account, stock exchanges were advised to introduce the settlement system

for direct delivery of securities to the investors' beneficiary account and it was stressed that any balance in the clearing member pool account shall be transferred to the beneficiary accounts of clients within 4 calendar days or 2 working days, whichever is later, beyond which such balances shall attract penalties.

- All new shares issued by an existing company were made should be initiated in all respects and the existing ISIN were allotted. Existence of multiple ISINs of a company created confusion in the depository system and led to frequent instances of instructions failure on account of wrong ISIN. This problem was eliminated due to the above decision.
- The exit route to small investors to sell 500 shares in physical form to continue in respect of shares included in the list of compulsory rolling settlement and dematerialised trading was continued.

The committee on dematerialisation of shares was also seized of the following issues below :

- Standardization of various procedures related to trading in depository system:
- Safety features and standards for depository operations:
- Expansion of depository infrastructure and making the branch offices with 'live' connectivity:
- Systemic tracking of delays at the hands of the depository participants, share transfer/issuer companies and depositories:
- Adequacy/capability of the depository system and systemic changes necessary to cope with the workload present as well as future:
- One stage processing for transfer and dematerialisation:
- Reduction in the size of batch processing from the present level of 1000 requests per batch:
- Good/bad delivery norms to be made mandatory on the registrars:

### *Beneficiary accounts with depository participants*

In order that the depository participants exercise utmost care and caution in the opening of beneficiary owner's accounts and diligently follow the instructions laid down for the purpose in various SEBI circulars, guidelines were issued requiring the depository participants to verify all documents with the original and the photographs and signature duly authenticated, before accounts are opened. These critical steps are necessary for the safety, integrity and efficient functioning of the depository system. It was also pointed out that any failure in this regard would invite appropriate regulatory action.

### *The depository participants were advised that:*

- A beneficiary account must be opened only after obtaining a proof of identity of the applicant. The applicant's signature and photograph must be authenticated by an existing account holder

or by the applicant's bank or after due verification made with the original of the applicant's valid passport, voter ID, driving license or PAN card with photograph.

- The account opening form should be supported with proof of address such as verified copies of ration card/ passport/ voter ID/ PAN card/ driving license/ bank passbook. An authorized official of the depository participant, under his signature shall verify the original documents.

All the depository participants were directed to immediately verify the accounts of all the beneficiary owners who had opened accounts with them and confirm in writing to the depository, within 30 days of the receipt of the instruction of SEBI, that they have fully complied with the above procedure in all the cases.

In case any account holder failed to produce the original documents for verification within the above period of 30 days, it was to be brought to immediate notice of the concerned depository. Failure to produce the original documents within the prescribed time would invite appropriate action against such account holders, which could even include freezing of their account.

### *System for direct delivery of securities to the investors*

In order ensure that securities are moved quickly to beneficiary accounts of investor and to prevent any possible misuse of pool accounts, it was decided that with effect from February 12, 2001:

- Clearing member shall be required to transfer the securities from their respective CM Pool account to the respective beneficiary account of their clients within 6 calendar days after the pay-out day, instead of the existing time limit of 15 days.
- Any balance lying in the pool account beyond the above period would not be eligible for delivery in the subsequent settlement(s) and would also not be eligible for pledging or stock lending purpose.
- The balances lying in the pool account beyond the above period would also attract a penalty at the rate of 6 basis point per week on the value of securities lying in the CM pool account. The penalty so collected shall be earmarked by the depository for defraying the expenses in connection with investors' education and awareness.
- Initially, the securities, which are lying in these accounts beyond the specified period, shall be identified on First-in First-out (FIFO) basis. However, it was decided that with effect from March 5, 2001, securities shall be identified based on the settlement number basis. The clearing corporations/houses were directed to provide the settlement-wise details of securities to the depositories and the depositories shall maintain the settlement-wise records for the purpose.

It was decided that this system will be introduced by stock exchanges with effect from April 2, 2001, which means that securities in the pay-out shall not be credited to Clearing Member Pool account except in exceptional circumstances. It was also decided that with effect from April 2, 2001, the time limit of 6 calendar days after the pay-out day shall be reduced to 4 calendar days or 2 working days, whichever is later. The penal provisions mentioned at point no.1 above, was made applicable on the balances lying in the pool account after this period.

### *Derivatives trading*

Derivatives are used as “Risk Management” products. Their availability in the Indian Securities Market would provide the participants with broad-based risk management tools.

The SEBI granted final approval to the derivative segment of the BSE and the NSE and their clearing houses / corporations for commencement of trading and settlement in SEBI approved derivative contracts on May 25, 2000. Trading in derivatives started with index futures contracts. The SEBI granted approval for trading in futures contracts based on BSE-30 (Sensex) index and on S&P CNX Nifty index. The trading and settlement in derivatives contracts would be in accordance with the rules, bye-laws and regulations of the respective exchanges and their clearing house / corporation duly approved by the SEBI and notified in the Official Gazette.

The BSE and NSE began trading in index futures contracts on June 9, 2000 and June 12, 2000 respectively. The NSE futures contract has S&P CNX Nifty as underlying index, whereas BSE started trading futures contract on BSE Sensex. The SEBI also laid down the risk containment measures for options on indices in December 2000. The SEBI proposed to lay down the risk containment measures for individual stock option contracts as recommended by Dr. L. C. Gupta Committee (introduction of derivative contracts in sequence such as index futures, index options and stock options).

Though the volumes in the derivatives market have been modest, each successive month has attracted higher volumes. Volumes in the derivatives market would grow with increased awareness amongst the participants and with introduction of multiple product range.

### *Technical group to identify new derivative products*

The technical group set up by the SEBI to identify new derivative products, which could be introduced in the market, headed by Prof. J.R Varma, full-time member, SEBI Board while taking the notice of the trading volumes in the index futures contracts recommended that the preparatory work for the introduction of other derivative products that would include options on indices, covered warrants and options on individual stocks. With introduction of stock options, Indian derivatives market would turn into a multi-product derivatives market.

### *Trading through the internet on the stock exchanges*

The SEBI allowed Internet Based Trading through order routing systems which stipulated to route client orders through exchange trading systems, for execution of trades on the existing stock exchanges. Only SEBI registered brokers can provide the service of internet based trading after obtaining permission from respective stock exchanges. The NSE and BSE have permitted their brokers to start internet based trading. The SEBI has prescribed minimum technical standards for ensuring safety and security of transactions between clients and brokers which would be enforced by the respective stock exchanges. Internet trading would provide benefits to investors as an added advantage of convenience, transparency and real – time trading.

To further promote internet trading, the SEBI appointed a technical committee which made the following recommendations subsequently adopted by the Standing Committee on Internet Based Securities Trading.

- Internet trading on wireless media using Wireless Application Protocol (WAP) was permitted subject to the adherence of all the requirements stipulated earlier by the SEBI for internet based trading and the minimum security features laid down in this regard. This will enable the WAP mobile device (mobile phones, Personal digital assistants, etc.) users to trade in securities using their mobile sets. This is expected to further extend the reach of the market and increase the number of investors, volumes and liquidity.
- On the issue of messaging standards between brokers, depositories / depository participants, and banks, it was decided to adopt the messaging standards on the lines of the standards being evolved by the RBI working group on Inter Bank Messaging Standards.
- For the derivatives trading on internet, the same minimum systems and operational requirements as have been laid down earlier for internet based trading by the SEBI, shall be applicable.

### **iii. Mutual Funds**

#### *Policy Initiatives*

In consultation with mutual funds industry, SEBI took a number of policy decisions during the year 2000-2001 to protect the interests of investors of mutual funds and to develop and regulate the mutual funds industry. The regulations were amended accordingly and necessary guidelines have been issued to the mutual funds. The details of policy decisions taken are as follows:-

#### *Guidelines for advertisements by mutual funds*

Guidelines on advertisement (supplementary to the Advertisement Code in the Regulations) were issued to mutual funds in order to bring about uniformity in disclosures of various categories of advertisements viz. (a) Tombstone Advertisement (b) Product Launch Advertisement and (c) Performance Advertisement and also to ensure consistency and comparability across the schemes of various mutual funds. The guidelines are also applicable to all sales literature and communications of mutual funds.

#### *Investments by mutual funds in mortgaged backed securities*

The SEBI (Mutual Funds) Regulations, 1996 were amended in order to permit mutual funds to make investment in mortgaged backed securities which are rated not below investment grade by a credit rating agency registered with the SEBI.

#### *Recording of investment decisions by mutual funds*

SEBI Regulations provide for exercise of due diligence by asset management companies (AMCs) in their investment decisions. For effective implementation of the regulations and also to bring

about transparency in the investment decisions, all the AMCs were required to maintain records in support of each investment decision which would indicate the data, facts and other opinion leading to an investment decision. While the AMCs can prescribe broad parameters for investments, the basis for taking individual scrip-wise investment decision in equity and debt securities would have to be recorded. The AMCs are required to report its compliance in their periodical reports to the trustees and the trustees are required to report to SEBI in their half-yearly reports. Trustees can also check its compliance through independent auditors or internal/statutory auditors or through other systems developed by them.

#### ***Payment of interest for delay in despatch of repurchase/ redemption proceeds***

In accordance with sub-clause c) of Regulation 53, in the event of failure to despatch repurchase/ redemption proceeds within the time specified in sub clause b) of the SEBI (MF) Regulations, (i.e. 10 working days), the mutual funds are now liable to pay interest to the unitholder, @ 15 per cent per annum, for the period of delay in despatch of these proceeds. Such interest would be required to be borne by the AMC. Details of such delays and interest paid to investors are required to be informed to SEBI by the mutual funds in their quarterly Compliance Test Report.

#### ***Guidelines on provisioning of non-performing assets***

Guidelines were issued to all mutual funds on identification and provisioning of non-performing assets (NPAs), criteria for classification of NPAs, treatment of income accrued on NPAs, provisions to be made on account of NPAs and disclosure of NPAs in half yearly portfolio reports.

#### ***Guidelines on valuation of securities***

Guidelines were issued on valuation of traded securities, thinly traded securities and non-traded securities. These guidelines were issued with a purpose of streamlining the procedure of calculation of NAV of the schemes of mutual funds.

#### ***Reduction in initial offer period and time taken for allotment of units and despatch of accounts statements***

The earlier limit of a maximum of 45 days for initial offer period was reduced to 30 days in case of open-ended schemes. The mutual fund are also required to despatch statements of accounts within 30 days from the closure of scheme instead of the earlier requirement of six weeks. The scheme is now required to open for ongoing sales and repurchases within 30 days from the closure of scheme. The AMCs were also been allowed to start despatching the statements of accounts once the minimum subscription amount specified in the offer document is received even before the closure of the issue.

#### ***Format for half yearly disclosure of portfolio***

In accordance with Regulation 59A, all mutual fund schemes are required to disclose their entire portfolios on half yearly basis. A common format for this purpose was prescribed so that



the investors get meaningful information on the deployment of funds. Mutual funds were required to disclose the investment in various type of instruments and percentage of investment in each scrip to the total NAV, illiquid and non-performing assets, investment in derivatives and ADRs/GDRs, etc.

### *Unclaimed redemption amount*

Guidelines were issued to mutual funds according to which the unclaimed redemption and dividend amounts can now be deployed by the mutual funds in call money market or money market instruments and the investors who claim these amounts during a period of three years from the due date shall be paid at the prevailing Net Asset Value. After a period of three years, this amount can be transferred to a pool account and the investors can claim the amount at NAV prevailing at the end of the third year. The income earned on such funds can be used for the purpose of investor education. The AMC has to make a continuous effort to remind the investors through letters to take their unclaimed amounts. In case of schemes to be launched in the future, disclosures on the above provisions are required to be made in the offer documents. Also, the information on amount unclaimed and number of such investors for each scheme is required to be disclosed in the annual reports of mutual funds

### *Annual reports of the AMCs to be made available to the unitholders*

SEBI issued a directive during the year that the annual report containing accounts of the asset management companies should be displayed on the websites of the mutual funds. It should also be mentioned in the annual report of mutual fund schemes that the unitholders, if they so desire, can request for the annual report of the asset management company.

### *Expenses chargeable by the AMC*

At present mutual funds charge certain expenses to the scheme as specified in Regulation 52(4). Apart from these expenses, any other expense as may be approved by the SEBI under clause (xiii) of Sub Regulation 52(4) can also be charged to mutual fund schemes. With a view to give flexibility to mutual funds, such other expenses, which are directly attributable to the scheme, can now be charged with the approval of the trustees within the overall limits as specified in Regulation 52 (6). However, a negative list of expenses has also been prescribed i.e. the expenses which cannot be charged to a scheme. Further, each item of expenditure accounting for more than 10 per cent of total expenditure should be disclosed in the accounts or the notes thereto of the schemes.

### *Prior approval for investment in unrated debt instruments*

Mutual funds were required to get prior approval of the board of trustees and AMCs to invest in unrated debt instruments. In order to give operational flexibility, mutual funds can now constitute committees who can approve proposals for investments in unrated debt instruments. However, the detailed parameters for such investments must be approved by the AMC boards and trustees. The details of such investments are required to be communicated by the AMCs to the trustees in their periodical reports and it should be clearly mentioned how the parameters

have been complied with. However, in case a security does not fall under the parameters, the prior approval of the board of the AMC and trustees is required to be taken.

### ***Guidelines for investment / trading in securities by employees of AMCs and mutual fund trustee companies***

SEBI formulated guidelines for investment/ trading in securities by employees of AMCs and mutual fund trustee companies so as to avoid any conflict of interest or any abuse of an individual's position and also to ensure that the employees of AMCs and trustee companies should not take undue advantage of price sensitive information about any company.

It was decided that access persons i.e. the employees who have access to investment decisions of the mutual fund should take prior approval before making any investment. Other employees who do not have such access will be required to report their transactions. Access persons will also be prohibited from making profits by selling securities within 60 days of buying them.

The boards of AMCs and trustee companies are required to review the procedures concerning personal investments by the employees and any violations requiring remedial action. Any such violation and action taken by the mutual funds would have to be reported to SEBI in the periodical reports

### ***Better disclosures in half-yearly results by mutual funds***

The mutual funds were required to publish unaudited financial results in the newspapers, before the expiry of two months from the close of each half year i.e. March 31 and September 30 in the prescribed format. It was observed that the reports were too cumbersome and as a result the investors were not getting meaningful information from the disclosures in the reports. Moreover, in many cases the print of such advertisements was so small that it was not readable.

In order to provide the investors with some meaningful information regarding the operations of mutual funds schemes, the format for half-yearly results was revised and guidelines were issued to mutual funds. A lot of information which was not available to investors earlier would have to be disclosed in the revised format like disclosure on unit capital, reserves, performance in terms of dividend and rise/fall in NAV during the half-year period, annualised yields over the last 1,3,5 years and also since inception, percentage of management fees, percentage of recurring expenses to the net assets, investment made in associate companies, payment made to associate companies for their services, details of large holdings, etc. Thus the investors would get all relevant information in a concise format.

Further, the mutual funds were required to publish the disclosures within one month of the close of each half-year. Further, they must publish the half-yearly results in at least 7 point font with proper spacing for easy readability.

### ***Reporting of securities transactions by directors of asset management companies***

According to SEBI Regulations, the directors of the AMCs were required to file a statement of holdings in securities with the trustees at the end of each financial year but they were not

required to disclose the details of their purchase and sale transactions in securities during the course of the year. SEBI issued directives that the directors of AMC's should file the details of their purchase and sale transactions in securities on a quarterly basis. As in the case of trustees, they may report only those transactions which exceed the value of Rs. 1 lakh.

#### *Updating the offer document on a continuous basis by mutual funds*

It has been observed that the disclosures in the offer documents of open-ended schemes are not updated periodically and new investors have to refer the offer document prepared at the time of launch of the scheme for making an investment decision. Over a period of time, there may be various changes of material nature like constitution of the AMC, imposing or enhancing entry or exit loads, change in the key personnel of the AMC especially the fund manager, addition of new plans in the existing scheme, change in management/controlling interest, fresh adjudication cases referred by SEBI, penalties imposed, etc.

Considering the fact that the offer document or the memorandum containing key information is the main basis of reference for any investor who intends to invest in a scheme, the SEBI issued directives that the offer document should be revised and updated at least once in two years. Till the time the offer document is revised and reprinted, an addendum giving details of the changes may be attached to offer documents and abridged offer documents. The addendum should be circulated to all the distributors/brokers so that the same can be attached to all offer documents and abridged offer documents already in stock. The addendum will also be sent to the existing unitholders.

After completion of one year of any open-ended scheme, the condensed financial information of the scheme as per format specified in the standard offer document has to be included in the offer document and this information has also to be updated in the subsequent years in the form of addendum to the offer document till the time new revised offer document is printed.

The applicability of loads is also required to be disclosed in the statement of accounts or in the covering letter issued to the unitholders so that they are fully aware how it would affect their yields.

The purpose of the above measures is that the investors get all material information before they take investment decisions.

#### *Reduction in Time frame for despatch of dividend warrants*

As per the provisions of Regulation 53 (A), all mutual funds are required to despatch dividend warrants to the unitholders within 42 days of the declaration of the dividend. SEBI issued directive that the present requirement of 42 days should be reduced to 30 days so that the investors get dividend within a shorter time period.

#### *Daily NAVs and sale/repurchase prices on AMFI website*

The NAV and sale/repurchase prices of all schemes are now required to be declared on a regular basis and are to be updated daily on the AMFI Website by 8 p.m. Thus, the investors can get this information at one place.

### *Launching of additional plans under existing schemes*

Mutual funds can now launch additional plans (other than dividend and growth plans), which differ from the main scheme in terms of portfolio, maturity and any other characteristics in accordance with the guidelines which prescribe detailed disclosure requirements.

### *Publication of NAV of close-ended schemes on Wednesday*

In order to bring uniformity in the industry and also to enable comparison and analysis of performance, all the mutual funds are now required to declare the NAVs of their close-ended schemes on every Wednesday. Earlier, the mutual funds were declaring such NAVs on different days of the week.

### *Collective Investment Schemes (CISs)*

The SEBI (Collective Investment Schemes) Regulations, 1999 were notified on October 15, 1999. With the notification of the Regulations, no person other than a Collective Investment Management Company which has obtained a certificate of registration under the SEBI (Collective Investment Schemes) Regulations, 1999 can carry on or sponsor or launch a Collective Investment Scheme. Also, no existing Collective Investment Scheme can launch any new scheme or raise money from the investors even under the existing schemes, unless a certificate of registration is granted to it under the said Regulations. Further, an existing collective investment scheme which has (i) failed to make an application for registration to the Board; or (ii) not been granted provisional registration by the Board; or (iii) having obtained provisional registration fails to comply with the provisions of Regulation 71; shall have to wind up its existing schemes and make repayment to the investors.

Prior to the notification of the Regulations, as a follow up to the Governments' directions, that schemes through which instruments like agro bonds, plantation bonds etc. are issued would be treated as "Collective Investment Schemes" coming under the provisions of Sec.11 (2)c of the SEBI Act, SEBI vide its press release dated November 26, 1997 and its public notice dated December 18, 1997 had directed existing Collective Investment Schemes (CISs) entities to file the details of their schemes with the SEBI.

### *Venture Capital Funds*

SEBI had set up K B Chandrasekhar Committee to identify the impediments in the development of venture capital industry in India and to suggest suitable measures for its rapid growth. The report of the Committee was submitted to the SEBI Board in January 2000. The recommendations of the Committee were widely discussed. The recommendations were accepted in-principle by the Government also and pursuant to the same, the Finance Minister in the Budget 2000 speech announced that SEBI would be the single point nodal agency for registration and regulation of both domestic and overseas venture capital funds and the SEBI registered Venture Capital Funds would be given total tax pass-through.

In the light of the recommendations of the SEBI Committee on Venture Capital and the Budget announcements, the Board of SEBI in its meeting held on September 14, 2000 approved the

SEBI (Venture Capital Funds) (Amendment) Regulations, 2000 and also the SEBI (Foreign Venture Capital Investors) Regulations, 2000.

The SEBI (Substantial Acquisition of Shares and Takeover) Regulations were amended whereby the acquisition of shares from venture capital funds/foreign venture capital investors either by company or by any promoter/s (on the same footing as that of acquisition from the state level financial institutions) would be exempt from making an open offer to other shareholders.

The venture capital funds/foreign venture capital investors are eligible to participate in the IPO through book building route as Qualified Institutional Buyer subject to compliance with the SEBI (Venture Capital Fund) Regulations. Board also approved the amendment in the SEBI (Mutual Fund) Regulations permitting mutual funds to invest in venture capital funds.

SEBI notified the Foreign Venture Capital Investors, Regulations, 2000 on September 15, 2000.

The SEBI submitted a proposal to the Government to reconsider the condition of exit from investment within one year from the date of listing of shares of venture capital undertaking to seek tax pass-through, Government agreed to remove such condition. Accordingly, the Board at its meeting held on December 22, 2000 amended the regulations removing the clause requiring mandatory exit.

The SEBI advised all the registered venture capital funds vide circular no. Cir-1-2001 dated February 12, 2001 to report every quarter about their resource mobilisation and investments.

*A) The following are the salient features of SEBI (Venture Capital Funds) (Amendment) Regulations, 2000:*

1. Definition of venture capital fund : The Venture Capital Fund is now defined as a fund established in the form of a trust, or a company including a body corporate and registered with SEBI which:
  - A. has a dedicated pool of capital;
  - B. raised in the manner specified under the Regulations; and
  - C. to invest in Venture Capital Undertakings in accordance with the Regulations.”
2. Definition of venture capital undertaking: venture capital undertaking means a domestic company :-
  - (a) Whose shares are not listed on a recognised stock exchange in India
  - (b) Which is engaged in business including providing services, production or manufacture of articles or things, but does not include such activities or sectors which are specified in the negative list by the Board with the approval of the Central Government by notification in the Official Gazette in this behalf. The negative list includes real estate, non-banking financial services, gold financing, activities not permitted under the Industrial Policy of the Government of India.

3. Minimum contribution and fund size : The minimum investment in a Venture Capital Fund from any investor shall not be less than Rs. 5 lakh and the minimum firm commitment of the fund before the fund can start activities shall be atleast Rs. 5 crores.
4. Investment criteria : The earlier investment criteria has been substituted by a new investment criteria which has the following requirements :
  - disclosure of investment strategy;
  - maximum investment in single venture capital undertaking not to exceed 25 per cent of the corpus of the fund;
  - Investment in the associated companies not permitted;
  - atleast 75 per cent of the investible funds to be invested in unlisted equity shares or equity linked instruments.
  - Not more than 25 per cent of the investible funds may be invested by way of:
    - (a) subscription to initial public offer of a venture capital undertaking whose shares are proposed to be listed subject to lock-in period of one year;
    - (b) debt or debt instrument of a venture capital undertaking in which the venture capital fund has already made an investment by way of equity.
5. Disclosure and information to investors: In order to simplify and expedite the process of fund raising, the requirement of filing the Placement memorandum with SEBI is dispensed with and instead the fund will be required to submit a copy of Placement Memorandum/ copy of contribution agreement entered with the investors along with the details of the fund raised for information to SEBI. Further, the contents of the Placement Memorandum are strengthened to provide adequate disclosure and information to investors. The SEBI will also prescribe suitable reporting requirements for the funds on their investment activity.

*B) Government of India guidelines*

The Government of India (MOF) Guidelines for Overseas Venture Capital Investment in India dated September 20, 1995 have been repealed by the MOF after notification of SEBI Venture Capital Fund Regulations.

*C) The following are the salient features of SEBI (Foreign Venture Capital Investors) Regulations, 2000 :*

1. Definition of foreign venture capital investor : any entity incorporated and established outside India which proposes to make investment in Venture Capital Fund or Venture Capital Undertaking and registered with SEBI.



2. Eligibility criteria: entity incorporated and established outside India in the form of investment company, trust, partnership, pension fund, mutual fund, university fund, endowment fund, asset management company, investment manager, investment management company or other investment vehicle incorporated outside India would be eligible for seeking registration from SEBI. The SEBI for the purpose of registration shall consider whether the applicant is regulated by an appropriate foreign regulatory authority; or is an income tax payer; or submits a certificate from its banker or its promoters' track record where the applicant is neither a regulated entity nor an income tax payer.
3. Investment criteria: the same conditions as applicable in case of domestic Venture Capital funds.
4. Hassle free entry and exit: The foreign venture capital investors proposing to make venture capital investment under the Regulations would be granted registration by the SEBI. SEBI registered Foreign Venture Capital Investors shall be permitted to make investment on an automatic route within the overall sectoral ceiling of foreign investment under Annexure III of Statement of Industrial Policy without any approval from FIPB. Further, SEBI registered FVCIs shall be granted a general permission from the exchange control angle for inflow and outflow of funds and no prior approval of RBI would be required for pricing. However, there would be ex-post reporting requirement for the amount transacted.

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

##### *Grant of registration to domestic fund managers as deemed FIIs*

With a view to avoid discrimination between Indian and foreign fund managers, the SEBI (Foreign Institutional Investors) Regulations 1995 were amended on February 29, 2000 to permit domestic fund managers to also manage foreign funds. Consequently Indian portfolio managers and approved asset management companies who are registered portfolio managers can get a deemed Foreign Institutional Investor (FIIs) status under the Regulations. But this will be only for the purpose of managing the foreign funds. The management of foreign funds would involve procurement of FEMA approval (for convertibility of funds), appointment of domestic custodian and designated bank, daily reporting of transactions etc. As these requirements are stipulated in the above regulations only, the entities have been granted registration as deemed FII under the regulations. It may be highlighted that these entities can only manage funds raised abroad by authorised entities/funds and cannot make proprietary investments through this route. In other words, these entities have to fulfil the obligations cast on them under the Regulations such as appointment of designated bank and custodian, reporting of trades to SEBI and RBI etc. but cannot make proprietary investments. On the other hand, FIIs can invest their own funds also which facility is not available to Indian portfolio managers.

##### *Investment limit of foreign corporate bodies and foreign individuals increased*

SEBI (Foreign Institutional Investors) Regulations, 1995 were amended on October 20, 2000 permitting portfolio investment by each foreign corporate bodies and foreign individuals to invest upto 5 per cent of the total issued capital of the company.

***Investment in commercial paper by FIIs permitted***

SEBI (Foreign Institutional Investors) Regulations, 1995 were amended on February 13, 2001 permitting FIIs and the sub accounts to invest in commercial papers.

***Disinvestment by FIIs subsequent to expiry of registration***

SEBI (Foreign Institutional Investors) Regulations, 1995 were amended on February 13, 2000 in order to facilitate disinvestment of holdings by FIIs, which did not desire to renew registration.

**v. Intermediaries Associated with the Securities Markets****Primary Market Intermediaries*****Merchant bankers, underwriters and portfolio managers***

During the year, a committee was constituted to review the SEBI (Portfolio Managers) Rules and Regulations, 1993. The draft report of the committee is under preparation.

In May 2000, the SEBI (Portfolio Managers) Rules and Regulations, 1993 were amended to provide that portfolio managers may manage funds raised or collected or brought from outside India in accordance with the SEBI (FII) Regulations, 1995.

Part III gives further details of registration of merchant bankers, underwriters and portfolio managers during 2000-01.

**Debenture trustees**

Debenture trustees are registered and regulated by the SEBI under the provisions of SEBI (Debenture Trustees) Rules and Regulations, 1993. As on 31.3.2000, 38 debenture trustees were registered with SEBI.

Debenture trustees are required to submit quarterly reports in the prescribed format to SEBI. The SEBI is also conducting inspection of their activities. On the basis of quarterly reports and the inspection reports, the SEBI monitors the activities of the debenture trustees and take suitable action against them in case of violation/non-adherence to rules, regulations, etc. The quarterly report was amended vide circular dated April 19, 2000 to make the information called for from the DT comprehensive.

**Bankers to an issue**

Bankers to an Issue are registered and regulated by the SEBI under the provisions of SEBI (Bankers to an Issue) Rules and Regulations, 1994. Under these regulations, registration commenced in 1994-95. SEBI (Bankers to an Issue) Regulations, 1994 were amended (vide gazette notification dated September 30, 1999) making it mandatory for the intermediary to pay

the fees up front at the time of grant of certificate of registration and renewal there after. After amendment the registration fee is Rs.5,00,000/- and the renewal fee is Rs.2,50,000/-.

All registered bankers to an Issue were directed by way of circular on July 9, 1999 to submit the annual report as stipulated in our earlier circular dated April 21, 1995.

### **Registrar to an issue and share transfer agents**

Registrars to an Issue (RTI) and Share Transfer Agents (STA) are registered and regulated by the SEBI under the provisions of SEBI (Registrar to an Issue and Share Transfer Agents) Rules and Regulations, 1993. Under these regulations, registration commenced in the year 1993-94 and is granted under the two categories: category I to act as both registrar to an issue and share transfer agent and category II to act as either registrar to an issue or share transfer agents.

Registrars to an issue and share transfer agents are required to submit quarterly reports in prescribed format to SEBI. The SEBI is also conducting inspection of their activities. On the basis of the quarterly reports and the inspection reports, the SEBI monitors the activities of the registrars to an issue and share transfer agents and take suitable action against them in case of violation of provisions of rules, regulations and circulars etc.

SEBI (Registrars to an issue and Share Transfer Agent) Regulations were amended (vide gazette notification dated September 30, 1999) making it mandatory for the intermediary to pay the fees up front at the time of grant of certificate of registration and renewal there after. The registration fees for category I – Rs. 50,000/- and category II– Rs.30,000/-. The renewal fees for category I – Rs.40,000/- and category II – Rs.25,000/-

During the year, the SEBI (RTI/STA) Rules and Regulations were amended to provide that in-house STA need not fulfill the capital adequacy requirement of having a net worth of Rs 3 lakh.

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

### *Changes in the regulatory frame work for:*

#### *A. Amendment to Companies Act*

The companies Act, 1956 was amended by Companies (Amendment) Act, 2000. The amendments having a bearing on securities market are as under

### **Prospectus**

**Section 55 A inserted** wherein under Sections 55 to 58, 59 to 84, 109 to 122, 206, 206A and 207 SEBI is given power to administer those sections so far as they relate to issue and transfer

of securities and non - payment of dividend in case of listed public companies, and those public companies which intend to get their securities listed on any stock exchange in India.

### Shelf prospectus

**Section 60 A inserted** according to which a public financial institution, public sector bank or scheduled bank whose main object is financing may file a shelf prospectus. The above mentioned companies shall not file fresh prospectus at every stage of offer of securities but file only an information memorandum on all material facts relating to new changes created.

### Information memorandum

**Section 60 B inserted** which imposes conditions to be fulfilled with regard to information memorandum in respect of book building such as the circulating the information memorandum to be circulated at least prior to the opening of public issue. Information and red - herring prospectus shall carry same obligations applicable as in the case of prospectus and if there are any variations shall be highlighted and individually informed to the subscribers. In case of those advance subscribers the issuing company shall not encash subscription moneys or post dated cheques. Such subscribers shall be given an option to withdraw their applications after the intimation of variations in prospectus. Upon the closure of the offer a final prospectus stating total capital raised and other details in case of public company shall be filed with the SEBI and Registrar of Companies.

### Deemed public issue

**A proviso inserted to Sub - section (3) of 67** An offer to fifty persons or more shall be treated as public offer provided that this provision shall not be applicable to a non - banking financial companies or public financial institutions

**Sub section (3A) inserted after sub section (3), in Section 67** by which SEBI along with RBI is given power to make guidelines in respect of offer or invitation to the public by a public financial institution specified under section 4A or non-banking financial company's referred to in clause (f) of section 45-I of the Reserve Bank of India Act, 1934

### Initial offer of securities to be in dematerialised form in certain cases

**Section 68B is inserted** under which every listed company, making initial public offer of any security for a sum of rupees ten crores or more, shall issue the same only in dematerialised form.

### New issue of share capital to be only of two kinds

**Section 86 has been amended** enabling the companies to issue shares with differential rights as to dividend, voting or otherwise as may be prescribed.

**Section 88** has been deleted effecting in enabling companies to issue shares with disproportionate rights

### Debenture trust deed

**Section 117A inserted** which requires a trust deed for any issue of debentures to be in prescribed form and to be executed within prescribed time.

### Appointment of debenture trustees and duties of debenture trustees

**Section 117B inserted** requires a company to appoint one or more debenture trustees before issuing a prospectus or a letter of offer to the public. The section also prescribes certain qualifications to be appointed as debenture trustee. The section also lays down obligation on debenture trustee to redress grievances of debenture holders.

### Liability of company to create security and debenture redemption reserve

**Section 117C inserted** requires a company which issued debentures after the commencement of this Act to create a debenture redemption reserve and adequate amount shall be credited out of profits of company until debentures are redeemed. The said reserve shall be used only for the aforesaid purpose and in accordance with terms and conditions of their issue.

### Passing of resolutions by postal ballot

**Section 192A inserted** provides for postal ballot wherein the company may in case of such matters as declared by the Central Government may, by notification, declare to be conducted only by postal ballot, shall get any resolution passed by means of postal ballot instead of transacting the business in general meeting of the company.

### Interim dividend

**Section 205 (1A)** inserted empowers Board of Directors to declare interim dividend and such amount shall be deposited in a separate bank account to be used only for payment of interim relief. Sections 205, 205A, 205C, 206, 206A and 207 shall, as far as may be also apply to any interim relief.

### Penalty for failure to distribute dividends within thirty days

**Section 207 is substituted by the following Section 207** “if a dividend has been declared and not been paid or the warrant has not been issued in thirty days, every director of the company is liable for a imprisonment for a term which may extend up to three years and a fine of one thousand rupees every day during which such default continues

Non compliance of above provision is not an offence provided if the dividend has not been paid

- (a) by reason or operation of law
- (b) a shareholder has given directions and those directions cannot be complied with
- (c) where there is a dispute regarding right to receive the dividend
- (d) the dividend has been adjusted against any sum due
- (e) for any other reason which was not due to any default on the part of the company

### Power to inspect

**In sub - section (1) of section 209A existing clause (ii) substituted** by the present clause (ii) empowers Central Government and the Securities and Exchange Board of India to conduct inspection with a notice to the company and **provided** that Securities and Exchange Board of India is can conduct inspection in respect of matters covered under sections referred to in section 55A

### Board's report

**Sub - section (2AA) inserted to section 217** which requires Board to include director's responsibility statement indicating

- that accounting standards have been followed in the preparation of the annual accounts
- that directors selected accounting policies applied them consistently, made judgements and estimates that are reasonable and prudent to give a true and fair view of the state of affairs of the company
- that the directors had taken proper and sufficient care for the maintenance of adequate accounting records
- that the directors had prepared the annual accounts on a going concern basis

**Section 224 (8) (aa)** empowers Comptroller and Auditor General to appoint auditor in respect of Govt companies and shareholders shall fix their remuneration in the AGM

**Section 226-(3) (e)** debars a shareholder of the company from being appointed as auditor of the company

**Section 252** requires a public company having paid up capital of five crores or more and thousand or more small shareholders may have a director elected by small shares in the manner prescribed by companies Amendment Rules 2001. The small shareholder has been defined to mean a shareholder holding share of nominal value of Rs. 20, 000/- or less

### Disqualifications of directors

**Clause (g) inserted in sub - section (1) of section 274** additional disqualifications added to include a person who has not filed the annual accounts for any continuous three financial years commencing on and after 1<sup>st</sup> April 1999 or has failed to repay its deposit or interest due or redeem its debentures or pay dividend and such failure continues for one year or more. He is also not eligible to be appointed as a director of any other public company for five years

**Audit Committee Section 292A inserted** which requires every public company having paid - up capital of not less than five crores of rupees to constitute a committee of Board known as "Audit Committee" with at least three directors as members and two thirds to be directors other than managing or whole - time directors and the Audit Committee has to comply the conditions specified in sub - sections (2) to (10) of section 292A



## Offer of Indian Depository Receipts

**Section 605A inserted** empowering Central Government to make rules applicable for the offer of, requirement of disclosure in prospectus or letter of offer in connection with, the manner to be dealt in a depository mode and by custodian and underwriters and the manner of sale, transfer or transmission of Indian Depository Receipts by a company incorporated or to be incorporated outside India, whether the company has or has not been established or, will not establish any place of business in India.

## Offences against Act to be cognizable

**Proviso inserted after first proviso in sub - section (1) of section 621** empowers courts to take cognizance of offence relating to issue and transfer of securities and non - payment of dividend on a complaint in writing by a person authorised by the Securities and Exchange Board of India.

## B. Companies Act - Rules /Amendments Rules

### I. Companies (Issue of Share Capital with differential Voting Rights) Rules, 2001

Every company limited by shares may issue shares with differential rights as to dividend, voting or otherwise, if the company -

1. has distributable profits
2. not defaulted in filing annual reports
3. has not failed to repay its deposits or interest or redeem its debentures on due date
4. has authority under Articles of Association to issue shares with differential rights
5. has not been convicted of any offence arising under Securities and Exchange Board of India Act, 1992 and Securities Contracts (Regulation) Act, 1956, Foreign Exchange Management Act, 1999
6. has not defaulted in meeting investor's grievances
7. has obtained approval of shareholders in General meeting by passing resolution
8. has approval of shareholders through postal ballot in case of listed public company
9. in the notice of meeting at which resolution is proposed to be proposed has sent an explanatory statement stating
  - (a) the rate of voting right
  - (b) the scale or in proportion to which the voting rights of such class or type of shares will vary
  - (c) the company shall not convert equity capital with voting rights into equity share capital

with differential voting rights and the rights with differential voting rights into equity share capital with voting right

- (d) the shares with differential voting rights shall not exceed 25 per cent of the total share capital issued
- (e) that a member of the company holding any equity share with differential voting rights shall be entitled to bonus shares, right shares of the same class,
- (f) the holders of the equity shares with differential voting rights shall enjoy all the other rights to which the holder is entitled to excepting right to vote as indicated in (a) above.

## **II. Companies (Appointment of the Small Shareholders' Director) Rules, 2001**

- 1) A company may suo motu elect a small shareholders' director from amongst small shareholders or upon the notice of small shareholders, who are not less than 1/10<sup>th</sup> of total shareholders.
  - 2) Such shareholders intending to propose a person shall leave a notice of at least 14 days before the meeting under the signature of at least 100 small shareholders
  - 3) The person whose name has been proposed for the post of small shareholders' director shall file his consent in writing with the company
  - 4) The listed public company shall elect small shareholders subject to sub - rules (1), (2) and (3) through postal ballot
  - 5) The unlisted company may appoint small shareholders nominee subject to above conditions if majority of small shareholders recommend
  - 6) Tenure of small shareholders' director shall be for a maximum period of 3 years subject to the requirement of provisions of Companies Act except that he need not have to retire by rotation.
  - 7) After the expiry of Tenure the same person if so desired by small shareholders may be elected for a period of another 3 years.
  - 8) Small shareholders shall be treated as director for all purposes except for appointment as whole - time director.
5. Disqualification of person to be appointed as small shareholders' director if he
- (i) has been found to be of unsound mind
  - (ii) is an undischarged insolvent
  - (iii) has applied to be adjudicated as an insolvent

- (iv) has been convicted by a Court for any offence involving moral turpitude and sentenced to imprisonment for not less than six months
  - (v) has not paid any call in respect of shares the company
  - (vi) an order disqualifying him for appointment as director has been passed by a Court
6. A person appointed as small shareholders' directors shall vacate the office
- (i) if he ceases to be a small shareholder
  - (ii) he has been disqualified by virtue of rules (1) or rule (5)
  - (iii) if he fails to pay any call in respect of shares of the company
  - (iv) he absents himself from three consecutive meetings of the Board of directors or from all the meetings of the Board for a continuous period of three months whichever is longer
  - (v) he is a partner of any private company of which he is a director, accepts a loan or any guarantee or security for a loan from the company in contravention of section 295
  - (vi) he acts in contravention of section 284
  - (vii) he becomes disqualified by an order of Court under section 203
  - (viii) he is removed in pursuance of section 299
7. No person shall hold office at the same time as small shareholders' director in the more than two companies.

### ***C. Amendments to SEBI Regulations***

#### **1. Debenture Trustees**

##### ***Securities and Exchange Board of India (Debenture Trustees) (Second Amendment) Regulations, 2000***

*(issued under S.O.No.743(E) published in the Gazette of India dated 8th August, 2000).*

- The definition of the term “associate” in relation to a debenture trustee, or body corporate has been widened to include a person who by himself (either directly or indirectly) or in combination with relatives, debenture trustee or the body corporate, director of the debenture trustee or the body corporate exercise control. ***[Reg. 2 (a)].***
- Restrictions have been put on debenture trustee to act for any issue of debentures if it is an associate of the body corporate or a moneylender to the body corporate. ***[Reg. 13A ].***
- Duty imposed on the debenture trustee to ensure that the debenture certificates are dispatched by the body corporate to the debenture holders within 30 days of the registration of the charge with the RoCs. ***[Reg.15(1) (g) (i) ].***

- Duty imposed on the debenture trustee to appoint a nominee director on the Board of the body corporate in the event of two consecutive defaults in payment of interests to the debenture holders or default in creation of security for debentures or default in redemption of debentures. [**Reg. 15(1)(m)**].
- Duty imposed on the debenture trustee to communicate to the debenture holders on half yearly basis the compliance of the terms of the issue by the body corporate, defaults (if any) in payment of interest or redemption of debentures and action taken therefor. [**Reg. 15 (1) (n)**].
- Duty imposed on the debenture trustee to ensure that the trust deed, inter alia, provide for the time limit for creation of the security for issue of debentures. [**Schedule IV (b)**].

## 2. Depositories and Participants

### *Securities and Exchange Board of India (Depositories and Participants) (Amendment) Regulations, 2000.*

*(issued under S.O.No.1160(E) published in the Gazette of India dated 26th December, 2000 ).*

- Status of a ‘sponsor’ given to the person acting alone or in combination with others holding not less than 51 per cent of the share capital of the depository as a sponsor and undertakes to perform the obligation under these regulations. [**Reg. 2 (1) (g)**].

## 3. Foreign Institutional Investors

### *3.1 Securities and Exchange Board of India (Foreign Institutional Investors) (Second Amendment) Regulations, 2000.*

*(issued under S.O.No.946(E) published in the Gazette of India dated 20<sup>th</sup> October, 2000).*

- For investment, in equity shares of a company by an FII on behalf of its sub-accounts, not to exceed 10 per cent of the total issued capital of the company, it is made mandatory on sub-accounts not to invest more than 5 per cent of the total issued capital of that company. [**Reg.15 (6)**]

### *3.2 Securities and Exchange Board Of India (Foreign Institutional Investors) (Amendment) Regulations, 2001*

*(issued under S.O 128 (E) published in the Gazette of India dated 13th February 2001)*

- Provided that a Foreign Institutional Investor who does not desire to renew its registration or has failed to make an application for renewal under sub-regulation (1), shall, at the time of expiry of registration, obtain a specific permission from the Board, for disinvesting the securities held by it on its own account or on behalf of its sub-account(s), within a stipulated time period, subject to such terms and conditions as may be specified by the Board. [**Reg 9 (1)**]
- Provided further that where a Foreign Institutional Investor does not desire to renew registration of any of its sub-account(s) or has failed to make an application for

renewal of registration of sub-account(s), the Foreign Institutional Investor shall at the time of expiry of registration, obtain, a specific permission from the Board, for disinvesting the securities held by it on behalf of sub-account(s) within a stipulated time period, subject to such terms and conditions as may be specified by the Board. **[Reg 9 (1)]**

- ‘Commercial paper’ **[Reg 15 (1) (e)]**

FII’s are now allowed to invest in commercial paper and according the following amendments were made

- In the explanation to proviso, the words, ‘commercial paper’, were inserted, after the words, ‘government securities’ and before the words, ‘and treasury bills’. **[Reg 15 (2)]**

In the first proviso, the words, ‘commercial paper’, were inserted, after the words, ‘government securities’ and before the words ‘including treasury bills’. **[Reg 15 (3) (c )]**

## 4. Mutual Funds

### 4.1 Securities and Exchange Board of India (Mutual Funds) (Second Amendment) Regulations, 2000

(issued under S.O.No.484 (E) published in the Gazette of India dated 22<sup>nd</sup> May, 2000)– read with corrigenda dated 26<sup>th</sup> July, 2000.

- A duty imposed on the trustees to exercise caution while effecting changes in the fundamental attributes of any scheme or the trust and informing each unitholder by a written communication about the proposed change. **[Reg. 18 (15A) (i)].**
- It was also made mandatory on the trustees to give to the unitholders an option to exit at the prevailing Net Asset Value without any exit load, if the trustees require to effect change in fundamental attributes. **[Reg.18 (15A) (ii)].**
- To effect change in the controlling interest of the asset management company, it has been made mandatory to obtain prior approval of the trustees & the Board and to communicate in writing about the proposed change to the unitholder and publication of an advertisement in the daily newspapers in English and in the language of the region. Also to effect change in the controlling interest of the asset management company, the trustees are required to give an option to the unitholders to exit on the prevailing Net Asset Value without any exit load. **[Reg.22 (e)].**
- In case of securitised debts, the mutual fund can now invest not only in asset-backed securities but also mortgaged-backed securities. (previously this was restricted only to asset-backed securities). **[Reg. 43].**
- The investment in debt-instruments with extendable limit of 20 per cent is allowed to be made in mortgaged-backed securities debt which are rated not below investment grade by a credit rating agency registered with the Board. **[Schedule VII – Reg. 43 (1A) Second proviso to clause].**

- A mutual fund scheme can now invest upto 5 per cent of its NAV in the unlisted equity shares or equity related instruments in case of open-ended scheme. Further, in case of close-ended scheme, the mutual fund can now invest upto 10 per cent of its NAV. [**Schedule VII – Reg. 43 clause 11**].

#### **4.2 Securities and Exchange Board Of India (Mutual Funds)(Amendment) Regulations, 2001**

*(issued under S.O. 69. (E) Published in the Gazette of India dated 23<sup>rd</sup> January 2001)*

- Thinly traded securities as defined in the guidelines shall be valued in the manner as specified in the guidelines issued by the Board. [**Schedule VIII clause (6)**]
- The aggregate value of illiquid securities as defined in the guidelines shall not exceed 15 per cent of the total assets of the scheme and any illiquid securities held above 15 per cent of the total assets shall be valued in the manner as specified in the guidelines issued by the Board. [**Schedule VIII clause 7**]
- Where income receivable on investments has accrued but has not been received for the period specified in the guidelines issued by the Board, provision shall be made by debiting to the revenue account the income so accrued in the manner specified by guidelines issued by the Board [**Schedule IX clause (g)**]
- The Balance sheet shall disclose under each type of investment(s) the aggregate carrying value and market value of non performing investments. An investment shall be regarded as non –performing if it has provided no returns in the form of dividend or interest for a period specified in the guidelines issued by the Board. [**Schedule XI clause 3 (iii)**]

#### **6. Stock Brokers and Sub-Brokers**

##### **Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) (Second Amendment) Regulations, 2000**

*(issued under S.O.No.787(E) published in the Gazette of India dated 30th August, 2000 ).*

- Turnover of the sub-broker of a subsidiary company acting as a stock broker of the stock exchange has been made liable to be excluded from the turnover of the stock broker if the stock broker has paid five years turnover-based fees plus fee for a block of five years on the concerned stock exchange which has formed the subsidiary company.” [**Schedule III – para 4A ]**

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

##### **Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2000.**

*a) (issued under S.O.No.1178(E) published in the Gazette of India dated 30th December, 2000)*

- Provisions contained in regulations 10, 11 and 12 of the Regulations shall, inter lia, not apply to “the transfer of shares from venture capital funds or foreign venture



capital investors registered with the Board to promoters of a venture capital undertaking or venture capital undertaking pursuant to an agreement between such venture capital fund or foreign venture capital investors with such promoters or venture capital undertaking.” **[Reg. 3 (1) (ia)].**

## 8. Venture Capital Funds

### 8.1 Securities and Exchange Board of India (Venture Capital Funds) (Amendment) Regulations, 2000.

- a) (issued under S.O.No.831(E) published in the Gazette of India dated 15th September, 2000)
- The term ‘associate’ has been defined to mean a person who (directly or indirectly, by himself or in combination with relatives, exercises control over the venture capital fund; or in respect of whom the venture capital fund, directly or indirectly, by itself, or in combination with other persons, exercises control; or whose director, is also a director, of the venture capital fund. **[reg.2 (aa)].**

[To note: The said definition has been substituted by the term ‘associate company’ by Securities and Exchange Board of India (Venture Capital Funds) (Second Amendment) Regulations, 2000. (issued under S.O.No.1179 (E) published in the Gazette of India dated 30<sup>th</sup> December, 2000).

### 8.2 Securities and Exchange Board of India (Venture Capital Funds) (Second Amendment) Regulations, 2000.

(issued under S.O.No.1179(E) published in the Gazette of India dated 30<sup>th</sup> December, 2000).

- The term “associate company” has been defined. For a company to be called “associate company” it is made mandatory on the director / trustee / sponsor / settler of the venture capital fund or asset management company to hold, either individually or collectively, equity shares in excess of 15 per cent of the paid up equity share capital of venture capital undertaking. **[Reg. 2 (aa)].**
- For a Venture capital fund to get its units listed on any recognised stock exchange it is made mandatory on it to complete 3 years from the date of the issuance of units by the venture capital fund. **[Reg. 13].**

## 9. Amendments to SEBI (Disclosure and Investor Protection) Guidelines, 2000

### 1. DIP (Compendium) Circular No.3 dated August 4, 2000 -

#### (a) Eligibility Norms:

- (i) The eligibility norms have been modified to provide that the IPOs of issue size upto 5 times the pre issue networth shall be allowed only if the company has a track record of distributable profits and a pre issue networth of not less than Rs.1 crore in three out of preceding five years.

- (ii) The companies not satisfying the above requirement may make IPO only through book building route subject to the condition that 60 per cent of the issue size is allotted to the Qualified Institutional Buyers.
  - (iii) Public issue by listed companies for more than five times of its pre issue networth is allowed only if the issue is made through book building route subject to the condition that 60 per cent of the issue size is allotted to the Qualified Institutional Buyers.
  - (iv) A listed company which has changed its name so as to indicate that it is a company in the information technology sector during a period of three years prior to filing of the offer document shall comply with the requirements for unlisted companies.
- (b) Promoters contribution and lock-in requirements:
- (i) The lock-in provisions in respect of IPOs have been rationalised to provide that the minimum promoters' contribution shall be locked in for three years and entire pre issue share capital other than the capital locked in as promoters' contribution shall be locked in for a period of one year from the date of commencement of commercial production or the date of allotment, whichever is later. However, this will not be applicable to the pre issue share capital held by venture capital funds and the share capital held for a period of atleast one year at the time of filing of offer document and being offered to the public through offer for sale.
  - (ii) The promoters' contribution brought in the form of cash either before or with the issue shall be kept in an Escrow Account with a scheduled commercial bank which shall be released to the company along with the public issue proceeds. Where the contribution has been brought prior to the issue and has already been deployed by the company, a cash flow statement shall be given in the offer document disclosing the use of funds.
  - (iii) The instruments allotted on preferential basis to any person including promoters / promoters group shall be locked in for a period of one year from the date of allotment except for such allotments on preferential basis which involve swap of equity shares / securities, for acquisition. This requirement shall be in addition to the lock in requirement of promoters' contribution.
- (c) Issue obligations: / contents of the offer document
- (i) It has been required that the lead manager shall file the draft offer document with the stock exchanges where the securities are proposed to be listed and make the copies of the offer document available to the public. Lead manager shall also obtain and furnish to the Board, an in-principle approval of the stock exchanges for listing of the securities within fifteen days of filing of the draft offer document with the stock exchange.
  - (ii) In the offer document a statement of the Board of Directors shall be included to the effect that the utilisation of monies received under promoters' contribution, firm allotments and reservations and the details of all unutilised monies.

- (iii) The requirement of incorporation of forecast of estimated profits and financial projections have been done away with.
  - (iv) The company is required to provide the accounting ratios to justify the basis of issue price and in case of book built issues it has to disclose that the final price has been determined on the basis of demand from the investors.
  - (v) The lead manager has been required to ensure that the despatch of share certificates / refund orders / cancelled stock invests / demat credit is completed and the listing documents are submitted to the stock exchange within two working days of finalisation of the basis of allotment and listing and commencement of trading are done within seven working days of the finalisation of basis of allotment.
- (d) Listing requirements - A company in eligible sector i.e. a company deriving 75 per cent or more of its turnover from information technology/ media / entertainment or telecommunication activities during the preceding two years, may offer 10 per cent of its securities to public subject to the conditions specified in the guidelines.
- (e) Preferential issue guidelines - It has been decided to strengthen the disclosure requirements in the notice for the general meeting in terms of section 173 of the Companies Act and to require the disclosure requirement of utilisation of money out of the preferential issue under an appropriate head in the balance sheet indicating the purpose of such utilisation. The details of unutilised monies is also to be disclosed under a separate head in the balance sheet indicating the form of investments of such unutilised money.

## **2. *DIP (Compendium) Circular No.4 dated September 6, 2000***

- (a) The companies are allowed to issue unsecured sub-ordinate debt instruments which are not public deposits provided such issue is subscribed by QIBs or other investors who have given positive consent for subscribing to such instruments/obligations.

## **3. *DIP (Compendium) Circular No. 5 dated November 30, 2000***

- (a) It has been decided to allow the IPOs through stock exchange mechanism. A new Chapter XI A has been added to the Guidelines which shall be applicable in respect of fixed price issues as well as for the fixed portion of book built issues. The companies making issues of securities shall now have an option to issue securities through the on-line system of the stock exchange or the existing banking channel.
- (b) In the stock exchange mechanism the company shall enter into an agreement with a stock exchange including the regional stock exchange having the requisite system. The exchange shall appoint the registered brokers who shall be considered as the collection centre. The broker shall collect the money from the client and guarantee the payment from the client.

## **4. *Press Release dated 22<sup>nd</sup> December 2000 -***

- (i) In the meeting of the Board held on December 22, 2000 it has been decided that the companies in all sectors may be permitted to offer 10 per cent of securities issued to

public provided 20 lakh securities are offered to the public (excluding promoters' contribution) firm allotment and reservations and the size of the net offer to the public is atleast Rs.100 crores. Provided further that the issue is made only through book building method with allocation of 60 per cent to QIBs.

- (ii) It was also decided to remove the limit of Rs.25 crores and allow all companies to make issues through book building.

**5. *Press Release No.48/2001 dated March 15, 2001 - In the meeting held on March 15, 2001, the Board decided the following:***

- (a) Multiple Applications:
  - (i) Multiple applications i.e. two or more applications in single names and / or joint names with the first applicant being one and the same would not be permitted unless the applicant declares and identifies in all his applications except in first that he is making multiple applications and identify all such applications.
  - (ii) All these applications would be clubbed and considered in the higher category i.e. > 10 market lots.
  - (iii) The allotments on these applications would be completed in the same manner as that of normal applications but the dispatch of share certificates / credit to demat account will be frozen until the time the identity and genuineness of applicants is established.
- (b) Basis of Allotment - The present system of allotment in market lots is done away with. It has been decided that to prevent fractional allotment and allotments of miniscule value, the minimum allotment shall be higher of the one share or smallest integral number of shares that has a value of Rs.1, 000/- calculated on the basis of issue price.
- (c) Alternate source of applications - Applications can be made available through Internet, newspaper or photocopies of the printed application forms provided such applications are accompanied by abridged prospectus. The pre-numbering of such applications will not be necessary and the application numbers shall be assigned by the collecting bankers and / or registrar to issue at the time of accepting the application.
- (d) It has been decided to allow all companies to issue debt securities to the public without listing the equity, subject to the following conditions:
  - (i) The securities carry an investment grade credit rating. For issues above Rs.100 crores such rating from two credit rating agencies shall be required. The instrument may be secured or unsecured. The company satisfies the eligibility norms specified in the Guidelines.
  - (ii) A 20 per cent band on the coupon rate / pricing may be indicated at the time of filing of the draft offer document.
  - (iii) There is no partly paid up shares or other securities at the time of filing of the draft offer document. If the company proposes to issue equity to the public during

the period when it has only its debt instruments listed, it shall comply with the guidelines applicable to IPOs of equity. The equity of promoters may be listed along with IPO of equity.

- (iv) The issue of debt securities to the public shall be exempted from the requirement that there should be no outstanding warrants or other securities convertible into equity at a later date subject to the condition that the floor price for conversion is fixed and disclosed upfront in the offer document of the public issue of debt instrument.
- (v) The company shall have option to make the issue through book building process to ascertain and determine the coupon rate / price of the debt security.

## 10. Amendments to listing agreement

- By a Circular dated 6<sup>th</sup> April 2000, the stock exchanges have been advised to amend the clauses 20 and 22 of the Listing Agreement to the effect the announcement regarding dividends, rights, bonus shares, etc., can be made outside the market hour i.e. if such announcements have to be made before the opening of the market hours it can be made atleast half an hour before the market opens.
- By a Circular dated 10<sup>th</sup> April 2000, no delivery period arising out of the book closure of the record dates in respect of the scrips for which the delivery by all investors has been made compulsory in dematerialised form reduced to one settlement period i.e. one week.
- SEBI vide its Circular dated 27<sup>th</sup> April 2000 clarified that the companies which are already listed on one or more stock exchanges shall be allowed to change the standard denomination of the equity shares only if they are in compulsory demat list for all the investors announced by SEBI from time to time.
- SEBI vide its Circular dated 10<sup>th</sup> May 2000 specified that the statement showing variations between the projected utilisation of funds and / or projected profitability settlement made by it in the offer document and the actual utilisation of funds and / or actual profitability shall be provided on a quarterly basis and should be published along with the unaudited / audited financial results as required under clause 41 of the Listing Agreement.
- Vide Circular dated 4<sup>th</sup> July 2000, clause 41 of the Listing Agreement was amended pursuant to the recommendations of the Accounting Standard Committee to provide for limited review of the quarterly unaudited results by the auditors of the company. A copy of the review report shall be submitted to the stock exchange within 2 months from the close of the half-year if quarterly unaudited results in respect of any item varies by 20 per cent or more from the respective half-year results. A statement explaining the results to the stock exchanges along with a review report to be submitted in the prescribed format.
- By a Circular dated 25<sup>th</sup> July 2000, the format of review report was partially modified by substituting the word “misstatement” with “material misstatement”.
- Vide Circular dated 4<sup>th</sup> June 2000, the procedure for the listing was modified as under:

- Issuer to file the draft offer document simultaneously with stock exchange which are securities are proposed to be listed while filing the offer document in SEBI.
  - The stock exchanges shall accept or decline the request for in-principle approval for listing within 15 days of submission of the draft-offer document.
  - The lead manager shall furnish to SEBI the in-principle approval on stock exchanges within the said 15 days period and if no such in-principle approval is given, the issuer shall not proceed with the issue and the file shall be closed.
  - The details of in-principle approval to be disclosed in the offer document.
  - Despatch of share certificates / refund order / cancellation of stock invest and demat credit shall be completed and the allotment and listing agreement to be submitted to the stock exchanges within 2 working days of finalisation of the basis of allotment.
  - Regional stock exchange shall give its final approval for listing and trading within 3 working days thereafter.
  - The other stock exchanges should give automatic approval for listing and trading once the regional stock exchange gives its consent.
  - The lead manager to ensure that the issuer completes the formalities for listing and commencement of trading at all stock exchanges where the securities are to be listed within 7 working days of the finalisation of the basis of allotment.
- Vide Circular dated 10<sup>th</sup> July 2000, amendment to the Listing Agreement was made in connection with the recommendation of Shri Kumar Mangalam Birla Committee on corporate governance as under :
- Except in the case of Government companies, institutional directors on the Boards of Companies should be considered as independent directors whether the institution is an investment institution or a lending institution.
  - For the purpose of considering the limit on committees of which a director can serve public limited companies whether listed or not shall be included all other companies i.e. private limited companies or foreign companies shall be excluded. Further, 3 committees i.e. audit committee, the shareholder grievance committee and the remuneration committees shall be considered for this purpose.
  - Clause 43 of the Listing Agreement amended vide circular dated 10<sup>th</sup> August 2000 to provide that the funds raised through preferential offers and their actual utilisation as per the objects of the preferential offer shall also be made part of the same provision of disclosure as are applicable in case of raising of funds through public or rights issues.
- Vide Press Release dated 28<sup>th</sup> February 2000, SEBI specified minimum floating stock requirements for continuous listing as under :
- No preferential allotment or buy-back of listed companies to be permitted if as a result of such preferential allotment the non - promoter holding below the ceiling permitted



under the Disclosure & Investor Protection Guidelines at the point of entry i.e. 10 per cent for IT, media, entertainment and infrastructure companies and 25 per cent for others. In case of new companies the above limit i.e.10 per cent or 25 per cent to be maintained on continuous basis after listing also.

- In case of existing companies the non-promoter holding must be atleast 10 per cent. In case whether such holding is less than 10 per cent the companies will be given time upto 1 year to raise the level of non-promoter holding to 10 per cent or buy out the public shareholding in a manner specified under SEBI Takeover Regulations.
  - None of the above will apply to BIFR Cos
  - The stock exchange will monitor the level of non-promoter holding on half-yearly basis from the returns to be submitted by the companies.
- By a Circular dated 6<sup>th</sup> December 2000, no delivery period on account of book closure / record dates of corporate account such as for issue of dividends and bonus shares was abolished in respect of scrips which are traded in the compulsory dematerialised trading.
- Clause 16 of the Listing Agreement amended to provide for the gap between two book closures and record dates should be atleast 30 days instead of 90 days.
- Vide Circular dated 2<sup>nd</sup> September 2001, SEBI advised setting up of a separate monitoring cell to monitor compliance with provisions of corporate governance and the companies to submit a quarterly compliance report to the stock exchanges within 15 days from the under of the quarter.
- Vide Circular dated 15<sup>th</sup> January 2001, clause 20, 22, 36 & 41 of the Listing Agreement was advised to be amended to provide that companies shall immediately disclose all material information simultaneously to all the stock exchanges where the securities of the companies are listed. In respect of any material information arising out of any decision taken in the Board meetings including the announcement of the results, dividends, bonus, rights, etc., the information shall be furnished to the stock exchange within 15 minutes of the disclosure of the Board meeting.
- Clause 41 of the Listing Agreement was advised to be amended to provide that the companies have an option to publish the audited half-yearly financial results within two months instead of publishing the unaudited results within one month followed by a limited review within 2 months. Separate form for disclosure of quarterly results and review reports specified for banks as recommended by RBI.
- The disclosure requirements which are prescribed under Schedule VI of the Companies Act in respect of unutilised monies raised by issue and the form in which such unutilised funds have been invested shall also be disclosed under clause 41 of the Listing Agreement.

The companies were also advised vide circular dated 4<sup>th</sup> February 2000 to disclose the aggregate of non-promoter shareholding along with half-yearly results under clause 41 of the Listing Agreement with effect from March 31, 2000.

## **vii. Assessment and Prospects**

During the year under review, the SEBI took several measures for modernising the securities market and enhancing its fairness, transparency and efficiency. To this end the SEBI has carried out wide ranging reforms and reviewed its existing policies and regulations in primary market, secondary market, mutual funds, foreign institutional investments, takeovers and depositories. The SEBI stepped up its efforts to protect the integrity of markets also through various risk containment measures, surveillance system, and enforcement actions.

The measures announced by the SEBI towards the end of the financial year, especially the expansion of rolling settlement from July 2, 2001 to include all scrips which hitherto had the facility of trading with deferral products and further expansion of the list to cover all traded securities by January 2002, removal of all deferral products from July 2, 2001, expansion of the scope of derivative trading to include stock options, are changes which will significantly alter the market micro structure in the future. The shift from traditional account period settlement system to rolling settlement, alone is a measure, which marks an important change for any market. While in the short term this measure could adversely impact the liquidity of the market and result in the fall of turnover on the stock exchanges, in the long run, the beneficial impact of all these measures put together will be felt. However, for sustainability, acceptance and success of these measures, market would need to have additional facilities which are normally and widely available in developed and several developing markets wherever such changes in market structure have been successfully implemented. Some of these facilities would include wide availability of electronic fund transfer in all metros and in towns and cities which have terminals of BSE, NSE and other exchanges, margin trading in line with international practices, Continuous net settlement. These measures will not only ensure availability and flow of funds into the market in a regulated and transparent manner but also help reduce transaction cost.

In addition to the above measures, the Government had also announced that all stock exchanges would be corporatised wherein ownership, trading rights and management would be segregated. corporation with these objectives would significantly alter the traditional structure of the stock exchanges in the country. It will also have an impact on the functioning of the stock exchanges and is likely to lead to consolidation of stock exchanges as has been noticed in other markets. Steps would have to be taken by the SEBI to ensure successful implementation of corporatisation programme.

With the above objectives in view, in the short and medium term the SEBI intends to take the following initiatives. Some of these initiatives would need to be taken in coordination with the RBI.

- Draw up a plan for successful implementation of corporatisation and demutualisation of all stock exchanges.
- Implement successfully the programme of rolling settlement;
- Coordinate with RBI for speedy implementation of electronic funds transfers across the country in a time bound manner;

- Introduction of margin trading facility as available in several developed markets;
- Expand the scope of derivative trading by taking measures to encourage trading in existing derivative products and introduce new derivative products;
- Introduce VaR based margin system for the cash market and gross margining of all transactions;
- Streamline further the risk management system across market segments i.e. cash and derivatives market;
- Introduce unique client code on all stock exchanges for all market participants and investors;
- Introduce market wide index based circuit filters;
- Review constantly the existing depository system and take measures to further streamline and simplify the procedures for the benefit of investors and market participants and also introduce further safe guards to protect the interest of investors;
- Take steps for retail participation in Government securities market through trading of such securities in stock exchanges;
- Take steps to encourage securitisation of assets;
- Further enhance financial disclosures, both initial and continuing disclosure requirements;
- Introduce delivery versus payment system by enhancing the efficiency of funds settlement;
- Introduce web based system for collecting and disseminating corporate information;
- Improve disclosure standards for mutual funds and introduce further safeguards to protect interest of investors.

Further strengthening the surveillance system in the stock exchanges by implementing the stockwatch system in the stock exchanges.