PART ONE: POLICIES AND PROGRAMMES

The Annual Report of the Securities and Exchange Board of India (SEBI) for 2007-08 delineates the policies and programmes of SEBI and its working and operations during the financial year as per format prescribed by the Securities and Exchange Board of India (Annual Report) Rules, 1994. During the year, SEBI continued its endeavour to remain committed to achieve the three statutory objectives, namely: (a) protection of the interests of investors in securities; (b) development of the securities market; and (c) regulation of the securities market.

In alignment with these objectives, this Report provides the manner in which SEBI accomplished its responsibilities and exercised its powers during the year in terms of: (a) the Securities and Exchange Board of India Act, 1992; (b) the Securities Contracts (Regulation) Act, 1956; (c) the Depositories Act, 1996; and (d) certain provisions of the Companies Act, 1956. The Report also provides a review of the developments in the Indian securities market during 2007-08, in the context of changing dynamics of market regulations.

Against the backdrop of an increasing integration of global financial markets, SEBI channelised its efforts to bring out regulations to handle the domestic and global developments. Steps were taken to strengthen the regulatory framework by reviewing existing policies and programmes and issuing new guidelines and regulations to promote orderly growth of securities market. The underlying objectives were to ensure transparency, efficiency, fairness, safety, and integrity of the securities market in India. Major policy initiatives and developments in the securities market during 2007-08 are presented in Box 1.1.

Box 1.1: Major Policy Initiatives and Developments in the Securities Market during 2007-08

I. Primary Securities Market

Grading of Initial Public offerings (IPOs)

❖ *Grading of all IPOs was made mandatory. The grading would be done by credit rating agencies, registered with SEBI. It would be mandatory to obtain grading from at least one credit rating agency. The grading would be disclosed in the prospectus, abridged prospectus and in every advertisement for IPOs.*

Relaxation for Government Companies in Infrastructure Sector

❖ *In order to facilitate government companies / corporations, statutory authorities/ corporations or any special purpose vehicle engaged in infrastructure sector to raise funds in the Indian primary market through IPOs, SEBI relaxed certain provisions of SEBI (DIP) Guidelines.*

Introduction of Fast Track Issuances

❖ *To enable compliant listed companies to access Indian primary market in a time effective manner through follow-on public offerings and rights issues, SEBI introduced fast track issue mechanism. To make the issuance process fast, the earlier requirement of filing draft offer documents was amended and the need to file draft offer documents with SEBI and the stock exchanges was done*

Box 1.1: Major Policy Initiatives and Developments in the Securities Market during 2007-08

I. Primary Securities Market *(Contd.)*

away with.

Tightening of Eligibility Requirement for Qualified Institutions' Placement (QIP)

- *The eligibility criterion for companies desirous of making a QIP was amended. In addition to criteria specified in the guidelines for QIP, such companies were also required to have a listing history of at least one year on the date of issuance of notice to its shareholders for convening a general meeting in terms of Section 81(1A) of the Companies Act, 1956 to consider the QIP.*

Relaxation of Provision Relating to Issuance of Debt Securities

- *In order to facilitate the development of a vibrant primary market for corporate bonds in India, SEBI amended SEBI (DIP) Guidelines concerning Issuance of Debt Securities. The amendments were in regard to: a) requirement of credit rating from one agency as against two earlier, b) permitting below investment grade debt instruments; and c) removal of structural restrictions.*

Rationalisation of Certain Requirements Pertaining to Indian Depository Receipts (IDRs)

- *Amendments were made to permit all categories of investors to apply in IDR issues, subject to (i) at least 50 per cent of the issue being subscribed by QIBs, and (ii) the balance being made available for subscription to other categories of investors at the discretion of the issuer, which should be disclosed in the prospectus.*

Amendments to Guidelines for Preferential Issues

- *Preferential allotment guidelines were amended to enable companies with listing history of less than six months to raise money through preferential allotment, subject to complying with the modified pricing and disclosure norms. In addition, listed companies planning to make preferential allotment were required to obtain PAN from each applicant.*

Electronic filing through Corporate Filing and Dissemination System (CFDS)

- *SEBI decided to phase out EDIFAR gradually in view of a new portal, viz., CFDS put in place jointly by BSE and NSE. In this regard, Clause 52 was introduced in the Equity Listing Agreement. The portal offers a XBRL enabled common platform for listed companies to file their returns with stock exchanges. It also serves as a common place for investors to view information related to listed companies.*

Amendments pertaining to Issue Process

- *The amendments made to issue process were: a) mandatory quoting of PAN in application form, b) permitting of discount in issue price for retail investors/retail shareholders, c) providing definition for "retail individual shareholder" for listed companies, d) giving clarification on the term CEO/CFO, e) deleting of the chapter on "guidelines for issue of capital by designated*

Box 1.1: Major Policy Initiatives and Developments in the Securities Market during 2007-08

I. *Primary Securities Market* *(Contd.)*

financial institutions (DFIs), f) monitoring of issue proceeds and g) making of pledged shares eligible for computation of minimum promoters' contribution.

Amendments to Clause 41 of the Listing Agreement

- *The Clause 41 of the Listing Agreement was revised to provide an option to the listed companies to furnish either unaudited or audited quarterly and year-to-date financial results to the stock exchange within one month of the end of each quarter (other than the last quarter). In case the company opts to submit unaudited financial results, they will be subjected to limited review by the statutory auditors of the company (or in case of public sector undertakings, by any practising Chartered Accountant) and a copy of the limited review report will be furnished to the stock exchange within two months from end of the quarter. In case the company opts to submit audited financial results, they will be accompanied by the audit report. The revised clause also specified the manner of approval and authentication of the financial results and formats.*

Amendments to Clause 49 of the Listing Agreement

- *Clause 49 of the Listing Agreement was amended to provide for a monitoring agency on utilisation of issue proceeds, the report of which would be placed before the Audit Committee of the issuer company. The Audit Committee, in turn, would make appropriate recommendations to the Board of the issuer company. Issuer company was also required to state material deviations in the utilization of issue proceeds to the stock exchanges.*

II. Secondary Securities Market

Mandatory Requirement of Permanent Account Number (PAN) for All Transactions in the Securities Market

- *SEBI stipulated that PAN would be the sole identification number for all participants in the securities market, irrespective of the amount of transaction with effect from July 02, 2007. The objective was to strengthen the 'Know Your Client' (KYC) norms through a single identification number for all participants in the securities market for facilitating sound audit trail.*

Short Selling and Securities Lending and Borrowing (SLB)

- *SEBI specified the broad regulatory framework for short selling by institutional investors and a full-fledged securities lending and borrowing scheme. Accordingly, relevant amendments were made to SEBI (FII) Regulations, 1995 and SEBI (Mutual Funds) Regulations, 1996, enabling FIIs and Mutual Funds to participate in short selling and SLB.*

Margining of Institutional Trade in the Cash Market

- *In order to provide a level playing field to all the investors in the cash market as in the case of*

Box 1.1: Major Policy Initiatives and Developments in the Securities Market during 2007-08

II. Secondary Securities Market *(Contd.)*

derivatives market, SEBI mandated that all institutional trades in the cash market would be subject to payment of margins as applicable to transactions by other investors. It was specified that w.e.f. April 21, 2008, trades would be margined on a T+1 basis with margin being collected from the custodian upon confirmation of the trade.

Draft SEBI (Investment Advisers) Regulations, 2007

- *The draft SEBI (Investment Advisers) Regulations, 2007 were placed on the website inviting public comments and suggestions. The comments/ suggestions received were being examined.*

Derivatives Market

- *SEBI introduced (i) mini contracts in equity indices, (ii) options contracts with longer life/ tenure, and permitted exchanges to compute and disseminate volatility indices and bond indices.*

  Clearing members were permitted to accept Foreign Sovereign Securities as collateral from foreign institutional investors (FIIs) for exchange traded derivative transactions.

Corporatisation and Demutualisation (C & D) of Stock Exchanges

- *In conformity with the provisions of SEBI notified Securities Contracts (Regulation) (Manner of Increasing and Maintaining Public Shareholding in Recognised Stock Exchanges) Regulations, 2006 (MIMPS Regulations) and as part of Government of India Foreign Direct Investment (FDI) policy, 16 stock exchanges had completed demutualisation process by diluting at least 51 per cent of their equity shareholding to public other than shareholders having trading rights.*
- *SEBI withdrew the recognition of Saurashtra Kutch Stock Exchange Limited and Magadh Stock Exchange Limited for failing to comply with observations in the inspection report and Hyderabad Stock Exchange Limited was derecognised for its failure to complete the demutualisation process within the prescribed time.*

III. Corporate Debt Market

In order to develop a sound corporate debt market in India, SEBI took a number of policy initiatives with respect to the following areas: (i) setting up of reporting platforms for corporate bonds, (ii) setting up of trading platform for corporate bonds, (iii) issues pertaining to trading in corporate bonds, (iv) making amendments to the listing agreement for debentures, (v) issuing securitised debt instruments regulations, (vi) evolving policy guidelines on debenture trustees, (vii) introducing Repos in corporate bonds, (viii) facilitating setting up of quote dissemination platforms, (ix) simplifying corporate bond issuance norms and (x) framing of draft issue and listing regulations for corporate bonds.

Box 1.1: Major Policy Initiatives and Developments in the Securities Market during 2007-08

IV. Mutual Funds

Parking of Funds in Short-term Deposits of Scheduled Commercial Banks by Mutual Funds: Pending Deployment

- *In order to ensure that the funds collected in a scheme are invested as per the investment objective stated in the offer document, SEBI issued guidelines restricting parking of funds in short-term deposits of scheduled commercial banks – pending deployment.*

Extension of Time for Uploading of NAVs of Fund of Fund Schemes

- *In view of the practical difficulties being faced by the mutual funds in uploading the NAV of Fund of Fund schemes on AMFI's website and their own website, SEBI had decided that the time limit for uploading of NAV for fund of fund schemes will be extended to 10:00 am the following business day.*

Investment in ADRs/GDRs/Foreign Securities and Overseas Exchange Traded Funds (ETFs) by Mutual Funds

- *The aggregate industry-wise ceiling for overseas investments by mutual funds was raised to USD four billion and subsequently to USD five billion and within the overall limit, mutual funds could make overseas investments subject to a maximum of USD 300 million per mutual fund.*

Reduction in Expenses Charged by Index Fund Scheme

- *The limit on investment and advisory fee for index fund schemes was reduced to 0.75 per cent and the total expenses of the scheme including the investment and advisory fees to 1.5 per cent of the weekly average net assets. The reduced expenses and investment and advisory fees were made applicable to exchange traded index funds also.*

Short Selling and Securities Lending and Borrowing

- *Enabling provisions were made for mutual funds to engage in short selling of securities as well as lending and borrowing of securities vide notification dated October 31, 2007.*

Waiver of Load for Direct Applications

- *Keeping in view the interest of the investors, it was decided that no entry load would be charged for direct applications received by the Asset Management Company (AMC) i.e. applications received through the internet, submitted to AMC or collection centre/ Investor Service Centre that were not routed through any distributor/ agent/ broker.*

Box 1.1: Major Policy Initiatives and Developments in the Securities Market during 2007-08

IV. Mutual Funds *(Contd.)*

Removal of Initial Issue Expenses

- *In order to bring in more transparency and clarity to the investors in terms of expenses charged in close-ended Schemes, SEBI decided that there would not be any provision of charging initial issue expenses and amortisation of the same. All mutual funds should meet expenses connected with sales and distribution of schemes from the entry load.*

Standard Warning in Advertisements by Mutual Funds

- *SEBI directed Mutual Funds to enhance the time for display and voice on the standard warning to five seconds in audio visual advertisements. In case of audio advertisements, the standard warning would be read in an easily understandable manner over a period of five seconds.*

Load on Bonus Units and Units Allotted on Reinvestment of Dividend

- *SEBI decided AMCs should not charge entry as well as exit load on bonus units and units allotted on reinvestment of dividend.*

Dedicated Infrastructure Funds

- *Pursuant to the announcement made by Hon'ble Finance Minister in the Union Budget 2007-08, SEBI set up a four member Committee under the Chairmanship of Mr. U. K. Sinha (CMD, UTI AMC) to suggest a detailed action plan to promote flow of investment to the infrastructure sector through dedicated infrastructure mutual funds.*

Real Estate Mutual Funds

- *The guidelines for Real Estate Mutual funds were approved by the SEBI Board in June 2006. During 2007-08, steps were taken to address certain residual issues relating to accounting and valuation of assets, in discussion with AMFI, ICAI and Credit Rating Agencies. The necessary amendments to the SEBI (Mutual Fund), Regulations 1996 were thereafter notified on April 16, 2008.*

V. Foreign Institutional Investors (FIIs)

Registration of FII/Sub-Accounts, Issuance of P-Notes, Investment Limit in Debt Securities

- *SEBI issued directions modifying the criteria for registration of FII/Sub-Accounts and issuance of P-Notes by them.*

  The investment limit for FIIs in Government Securities (including Treasury Bills) was enhanced from USD 2.6 billion to USD 3.2 billion.

Box 1.1: Major Policy Initiatives and Developments in the Securities Market during 2007-08

VI. Rationalisation of Fee Structure

SEBI rationalized the fee structure by reducing fee ranging between 50 per cent to 90 per cent in case of filing of offer document for public/rightsc issues, offer for takeover and buy-back of securities, schemes of mutual funds, ad-valorum fee from custodians for assets under the custody and registration fee fromf venture capital funds.

VII. Regulatory Developments

❖ *The following Act was amended during 2007-08:*

- *Securities Contracts (Regulation) Act, 1956*

❖ *The following Regulation was framed during 2007-08:*

- *SEBI (Certification of Associated Persons in the Securities Markets) Regulations, 2007*

❖ *The following Regulations were amended during 2007-08:*

- *SEBI (Manner of Service of Summons and Notices Issued by the Board) (Amendment) Regulations, 2007*
- *SEBI (Mutual Funds) Regulations, 1996*
- *SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997*
- *SEBI (Buy-Back of Securities) Regulations, 1998*
- *SEBI (Merchant Bankers) Regulations, 1992*
- *SEBI (Depositories and Participants) Regulations, 1996*
- *SEBI (Foreign Institutional Investors) Regulations, 1995*
- *SEBI (Payment of Fees) (Amendment) Regulations, 2008*

GENERAL MACRO-ECONOMIC ENVIRONMENT

Indian economy remained as one of the fastest growing economies of the world and continued to expand during 2007-08, mainly driven by growth in industry and services sectors. However, there was moderation in the growth momentum during later part of the financial year. According to revised estimates of Central Statistical Organisation (CSO), real GDP grew at 9.0 per cent in 2007-08 in comparison to 9.6 per cent in 2006-07 (Table 1.1). Growth in the industrial sector was at 8.1 per cent, led by manufacturing activities which recorded a growth of 8.8 per cent in 2007-08 as compared to 12.0 per cent in 2006-07 (Table 1.2). The services sector continued to be the main driver of growth in India with double digit growth of 10.7 per cent for the fourth year in succession despite some moderation in pace during 2007-08. Growth in agricultural sector accelerated to

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

(Rs. crore)

Item	2005-06	2006-07 (Quick Estimates)	2007-08 (Revised Estimates)
1	2	3	4
A. Estimates at Aggregate Level			
1. National Product			
1.1 Gross National Product (GNP) at factor cost	25,93,160	28,45,156 (9.7)	31,09,361 (9.3)
1.2 Net National Product (NNP) at factor cost	23,06,894	25,30,495 (9.7)	27,67,682 (9.4)
2. Domestic Product			
2.1 Gross Domestic Product (GDP) at factor cost	26,12,847	28,64,310 (9.6)	31,22,862 (9.0)
2.2 Net Domestic Product (NDP) at factor cost	23,26,581	25,49,649 (9.6)	27,81,182 (9.1)
B. Estimates at Per Capita Level			
1. Population (million)	1,106	1,122 (1.5)	1,138 (1.4)
2. Per Capita NNP at factor cost (Rs.)	20,858	22,553 (8.1)	24,321 (7.8)

Note: Figures in the parentheses are percentage change over the previous year.
Source: Central Statistical Organisation.

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

(Rs. crore)

Industry	2005-06	2006-07 (Quick Estimates)	2007-08 (Revised Estimates)	Percentage Change over Previous Year	
				2006-07	2007-08
1	2	3	4	5	6
1. Agriculture, Forestry & Fishing	5,11,013	5,30,236	5,54,336	3.8	4.5
2. Mining and Quarrying	55,150	58,294	61,601	5.7	4.7
3. Manufacturing	3,93,557	4,40,770	4,79,456	12.0	8.8
4. Electricity, Gas and Water Supply	57,309	60,737	64,544	6.0	6.3
5. Construction	1,84,255	2,06,338	2,26,579	12.0	9.8
6. Trade, Hotels, Transport and Communication	6,86,738	7,67,884	8,60,212	11.8	12.0
7. Financing, Insurance, Real Estate and Business Services	3,59,942	4,10,030	4,58,364	13.9	11.8
8. Community, Social and Personal Services	3,64,883	3,90,020	4,18,307	6.9	7.3
GDP at Factor Cost	**26,12,847**	**28,64,310**	**31,22,862**	**9.6**	**9.0**

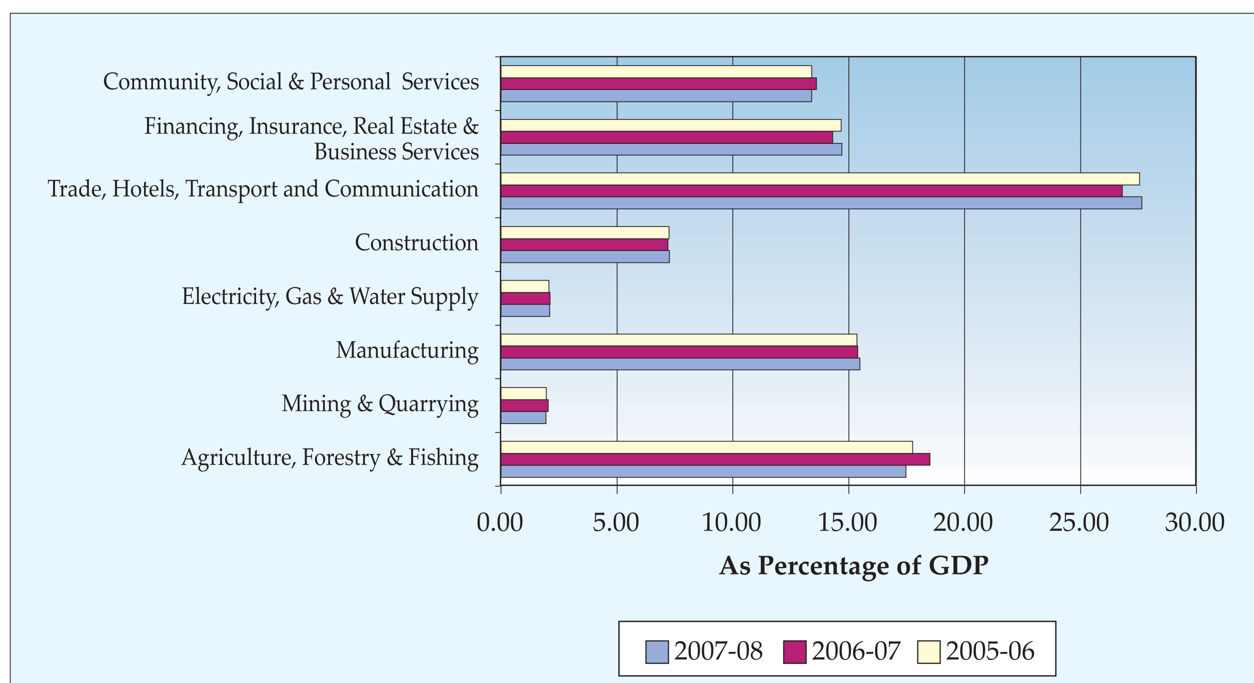
Source: Central Statistical Organisation.

4.5 per cent in 2007-08 from 3.8 per cent in 2006-07, though the share of 'agriculture and allied activities' in overall GDP declined from 18.5 cent in 2006-07 to 17.8 per cent in 2007-08 (Chart 1.1). In contrast, the share of services sector rose from 61.9 per cent to 62.9 per cent and the share of industry remained stable around 19.5 per cent. During the first year (2007-08) of the Eleventh Plan period (2007-12), India's real GDP grew at 9.0 per cent compared to 7.8 per cent (average) in the Tenth Plan period (2002-07).

Major factors contributing to a deceleration in the manufacturing activities were subdued exports, decrease in domestic demand and weak investment climate due to higher interest rate etc. Capital goods recorded a double digit growth implying addition to industrial capacity. Consumer goods sector saw a decline in growth rate mainly on account of a slowdown in consumer durables basket. 'Chemicals', 'beverages', 'tobacco and related products', 'leather products', 'jute textiles', 'wood products', 'basic metals and alloys' witnessed acceleration in growth in 2007-08. However, growth in the intermediate goods, basic goods and infrastructure sector remained sluggish. According to business expectations surveys, conducted by various agencies, India's industrial sector is likely to continue its strong performance in near future.

Services sector continued to remain the largest contributor to overall GDP growth and grew at 10.7 per cent during 2007-08. Within the services sector, 'trade, hotel, transport & communication' and 'financing, insurance, real estate & business services' maintained a lower but double digit growth in 2007-08. 'Community, social and personal services' grew marginally during 2007-08. Cargo handled by major ports, air cargo and rural penetration of mobile telephony showed improved performance. Power generation, railway freight movements alongwith production of universal intermediaries like

Chart 1.1: Share of Components of GDP (at Factor Cost)



steel, cement and petroleum showed subdued performance.

As per the latest data on India's savings and investments available up to 2006-07, by CSO, India's Gross Domestic Savings (GDS) as proportion of GDP at current market prices increased from 34.3 per cent in 2005-06 to 34.8 per cent in 2006-07 mainly on account of improvement in the saving performance by the private and public sectors. Public sector savings increased from 2.6 per cent in 2005-06 to 3.2 per cent in 2006-07. Private corporate sector savings also improved marginally from 7.5 per cent in 2005-06 to 7.8 per cent in 2006-07, on the back of healthy corporate profits. Savings of household sector decreased by 0.43 percentage points to 23.8 per cent in 2006-07 mainly on account of decline in financial saving rate after witnessing an increase in 2005-06. The Gross Domestic Capital Formation (overall investment), exceeded GDS by 0.4 percentage points to 35.9 per cent of GDP in 2006-07 reflecting net inflow of foreign savings.

Table 1.3 Gross Domestic Savings and Investment

Item	Amount in Rupees Crore				Per cent of GDP at current market prices			
	2003-04	2004-05	2005-06@	2006-07*	2003-04	2004-05	2005-06@	2006-07*
1	2	3	4	5	6	7	8	9
1. Household Sector Savings	6,70,776	7,25,110	8,66,756	9,85,822	24.26	23.19	24.21	23.78
a) Financial Assets	3,13,260	3,18,264	4,20,841	4,67,985	11.33	10.18	11.75	11.29
b) Physical Assets	3,57,516	4,06,846	4,45,915	5,17,837	12.93	13.01	12.45	12..49
2. Private Corporate Sector Savings	1,20,730	2,06,363	2,68,329	3,22,242	4.37	6.60	7.49	7.77
3. Public Sector Savings	29,521	68,951	92,263	1,33,359	1.07	2.21	2.58	3.22
4. Gross Domestic Savings (GDS)	8,21,027	10,00,424	12,27,348	14,41,423	29.69	32.00	34.28	34.77
5. Net Capital Inflow (+)/ Outflow (-)	-45,380	13,338	44,604	46,362	-1.64	0.43	1.25	1.12
6. Gross Domestic Capital Formation (GDCF)	7,75,647	10,13,761	12,71,953	14,87,786	28.05	32.42	35.53	35.89
7. Final Consumption Expenditure	20,13,844	21,86,542	24,35,298	27,51,116	72.82	69.93	68.02	66.36
a) Private Final Consumption Expenditure	17,03,547	18,48,490	20,62,222	23,24,109	61.60	59.12	57.60	56.06
b) Government Final Consumption Expenditure	3,10,297	3,38,052	3,73,076	4,27,077	11.22	10.81	10.42	10.30
Memo Items								
Savings Investment Balance (4-6)	45,380	-13,337	-44,605	-46,363	1.64	-0.43	-1.25	-1.12
Public Sector Balance#	-1,45,058	-1,48,011	-1,79,739	-1,88,214	-5.25	-4.73	-5.02	-4.54
Private Sector Balance#	2,53,185	1,93,546	2,11,679	1,87,213	9.16	6.19	5.91	4.52
a) Private Corporate Sector	-60,074	-1,24,718	-2,09,161	-2,80,772	-2.17	-3.99	-5.84	-6.77
b) Household Sector	3,13,259	3,18,264	4,20,840	4,67,985	11.33	10.18	11.75	11.29
Investment in Shares and Debenture	492	4,967	29,268	47,918	0.02	0.16	0.82	1.16

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

Source: Central Statistical Organisation, Reserve Bank of India.

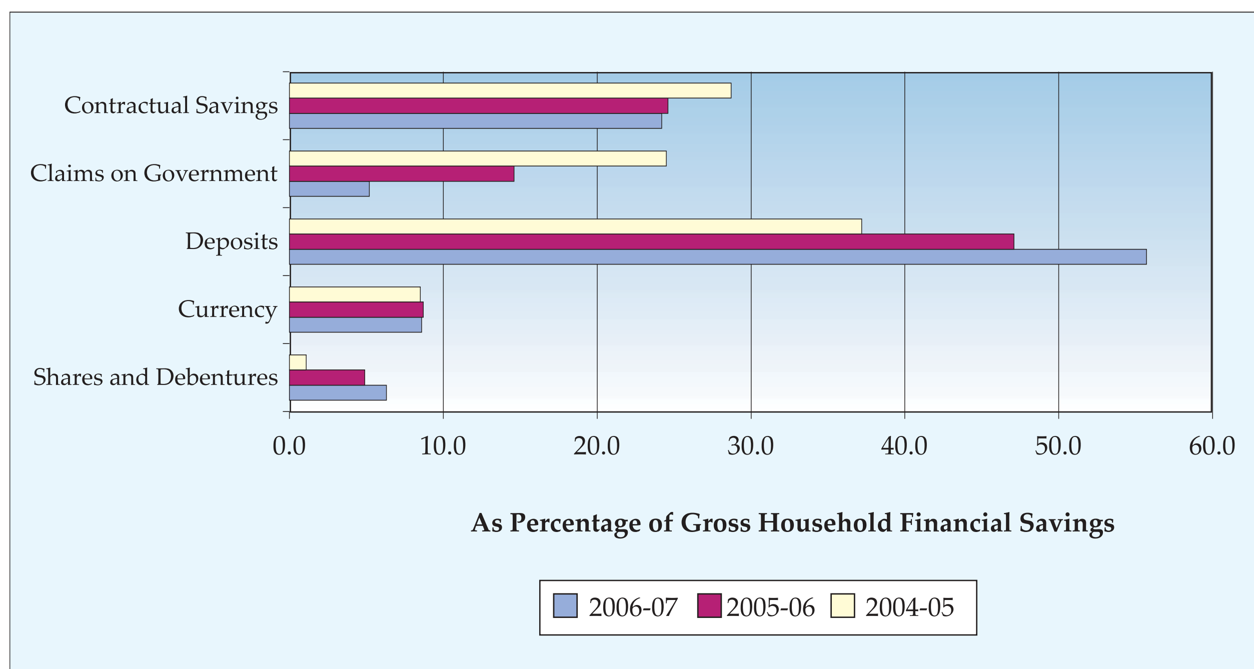
'Deposits' continued to dominate as a major component of gross financial savings by the households. The share of deposits in total financial savings increased from 47.1 per cent in 2005-06 to 55.7 per cent in 2006-07 (Chart 1.2). On the contrary, households' claims on Government declined from 14.6 per cent in 2005-06 to 5.2 per cent in 2006-07. Thus, there was a visible shift in the pattern of household financial savings from claims on Government to deposits due to higher returns available to them from various types of fixed and terms deposits offered by banks and financial institutions.

During 2006-07, other major components of financial savings were contractual savings, mainly insurance (15 per cent), followed by provident and pension funds (9.2 per cent) and currency (8.6 per cent). Investment in shares and debentures by the households as a proportion of gross total financial savings increased significantly from 4.9 per cent in 2005-06 to 6.3 per cent in 2006-07. Shares and debentures as proportion to GDP (at current market prices) improved from 0.8 per cent to 1.2 per cent during the same period.

Lending activities by commercial banks decreased during 2007-08 after experiencing an increase in previous fiscal. Non-food credit growth witnessed a decline to 22.3 per cent during 2007-08 as compared to 28.5 per cent in 2006-07 reflecting a fall in GDP growth in general and industrial activities in particular. Credit to services sector decelerated during 2007-08, including retail lending, particularly to the housing sector. High credit growth was observed for jute textiles, leather and leather products, basic metals and engineering goods. During 2007-08, deposit growth and credit growth almost matched with each other. The liquidity condition remained tight during the greater part of the year following monetary tightening and increase in cash reserve ratio (CRR) by Reserve Bank of India (RBI).

Though there was a rally in stock prices in the early part of the year under review,

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



financial markets remained volatile during the later part, particularly in the month of January 2008, when global stock price meltdown was mirrored in the Indian stock market.

Corporates restructured their debt profile and raised resources from securities markets and through external commercial borrowings apart from resorting to internal accruals. They mobilised sizeable amount of resources accessing the domestic securities markets through a number of public issues, rights issues, private placements and by offerings to private equities.

Inflation on a point to point basis, measured by variation in the Wholesale Price Index (WPI), was 7.4 per cent at the end of March 2008 compared to 5.9 per cent at the end of March 2007. On an average basis, the inflation rate was 4.7 per cent in 2007-08 compared to 5.4 per cent in the previous year. Prices of manufactured products (weight: 63.8 per cent in WPI) rose by 7.1 per cent compared to 6.1 per cent a year ago. Following the hardening of international crude oil prices, fuel group recorded a rise of 6.7 per cent in 2007-08 as against 1.0 per cent in the previous year. The rise in prices can be mainly attributed to food, crude oil and metals during the year.

India's import bill increased significantly during 2007-08. The major share was contributed by crude oil as well as non-oil imports on the back of strong industrial demand. As a result, trade deficit too widened during 2007-08. Bulk of trade deficit was financed through net receipts under invisibles, particularly through remittances from the Indian migrant workers abroad. Impressive capital flows, which more than offset the current account deficit, contributed to the accumulation of foreign exchange reserves of RBI. India's foreign exchange reserves rose by USD 110.5 billion to USD 309.7 billion during 2007-08, on account of rising inflow of foreign direct investment, foreign portfolio investment, External Commercial Borrowings and remittances. The Rupee vis-à-vis US dollar appreciated during the major part of 2007-08 following continued foreign capital inflows but receded in the later part following a reversal of flows due to the unfolding of sub-prime mortgage crisis in the U.S.

2. REVIEW OF POLICIES AND PROGRAMMES

SEBI initiated a number of policies and programmes during 2007-08 which are presented in this Section under six major heads *viz*,. primary securities market, secondary securities market, corporate debt market, mutual funds, foreign institutional investors, and investor assistance and investor education. The section is concluded with 'retrospect and prospects'.

I. Primary Securities Market

A developed primary market is crucial for resource mobilisation by corporates to meet their investment needs for growth. Since 2003-04, Indian primary market witnessed high activity in resource mobilisation and number of issues in the market, which continued during 2007-08 as well. The ongoing reforms in the primary market improved the confidence of the investors as well as the issuers. A number of companies entered the primary market for resource mobilisation. Response of investors to public issues was encouraging. A detailed analysis on number of issues, amount mobilised, size and composition of issues and industry-wise resource mobilised is given in the Part Two of this report. Following were the major policy initiatives taken by SEBI relating to the primary market during 2007-08:

i. Grading of Initial Public Offerings (IPOs)

Grading of all IPOs was made mandatory. The grading would be done by

credit rating agencies, registered with SEBI. It would be mandatory to obtain grading from at least one credit rating agency. The issuer would be required to disclose all the grades obtained by it for its IPO in the prospectus, abridged prospectus and all other places where the issuer advertised for the IPO. Expenses incurred for grading of IPO would be borne by the issuer.

ii. Relaxation for Government Companies in Infrastructure Sector

In order to facilitate government companies / corporations/ statutory authorities/ any special purpose vehicle set up by any of them, which are engaged in infrastructure sector, to raise funds in the Indian primary market through IPOs, SEBI relaxed certain provisions of SEBI(DIP) guidelines like:

a) minimum dilution requirements,

b) minimum period of holding of pre-issue capital to be issued in an offer for sale, and

c) eligibility of shares for the purpose of computation of promoters' contribution etc.

iii. Introduction of Fast Track Issuances

To enable well compliant listed companies to access primary securities market in a time effective manner through follow-on public offerings and rights issues, SEBI introduced fast track issue mechanism. This would enable listed companies to proceed with follow-on public offering / rights issue by filing a copy of the Red Herring Prospectus (in case of book-built issue) / Prospectus (in case of fixed price issue) with the Registrar of Companies or the letter of offer filed with designated stock exchange, as the case may be. Now such companies need not file a draft offer documents with SEBI and the stock exchanges.

iv. Tightening of Eligibility Requirement for Qualified Institutions' Placement (QIP)

The eligibility criterion for a company desirous of making a QIP was amended. In addition to the criteria specified in the guidelines governing QIP, such a company would also be required to have a listing history of at least one year on the date of issuance of notice to its shareholders for convening a general meeting in terms of Section 81(1A) of the Companies Act, 1956 to consider the QIP.

v. Relaxation of Provision relating to Issuance of Debt Securities

In order to facilitate development of a vibrant primary market for corporate bonds in India, SEBI amended SEBI (DIP) Guidelines concerning Issuance of Debt Securities. The amendments were as under:

a) Requirement of Credit Rating

For public/ rights issues of debt instruments, SEBI (Disclosure and Investor Protection) Guidelines, 2000, stipulated credit rating to be obtained from not less than two credit rating agencies. With a view to reducing the cost of issuance of debt instruments, it was amended that credit rating from one credit rating agency would be sufficient.

b) Below Investment Grade Debt Instruments

SEBI (Disclosure and Investor Protection) Guidelines, 2000, required that the debt instruments issued through a public/ rights issue shall be of at least investment grade. In a disclosure based regime, it is left to the investor to decide whether or not to invest in a non-investment grade debt instrument. Given this, and in order to develop market for debt instruments, it was decided to allow issuance of bonds below

investment grade to the public to suit the risk/return appetite of investors.

c) Removal of Structural Restrictions

In order to provide issuers with flexibility in structuring of instruments to suit their requirements, the restrictions currently placed on debt instruments such as those on maturity, put/call option on conversion, etc., were removed.

vi. Rationalisation of Certain Requirements Pertaining to Indian Depository Receipts (IDRs)

Prior to these amendments, only Qualified Institutional Buyers (QIBs) were eligible to apply in an IPO of IDRs. However, amendments were made to permit all categories of the investors to apply in IDR issues, subject to (i) at least 50 per cent of the issue being subscribed by QIBs, and (ii) the balance being made available for subscription to other categories of investors at the discretion of the issuer, which should be disclosed in the prospectus. Further, the minimum application value was reduced from Rs. 2,00,000 to Rs. 20,000.

vii. Amendments to Guidelines for Preferential Issues

Prior to this amendment, the provisions relating to pricing in preferential issue guidelines, pre-supposed listing history of at least six months for the company proposing a preferential allotment. The amended preferential allotment guidelines enabled companies with listing history of less than six months also to raise money through preferential allotment, subject to complying with the modified pricing and disclosure norms.

Further, the listed companies intending to make preferential allotment would be required to obtain PAN from each applicant before making the allotment.

viii. Electronic Filing through Corporate Filing and Dissemination System (CFDS)

SEBI decided to phase out EDIFAR gradually in view of a new portal, viz., CFDS put in place jointly by BSE and NSE, which offers a Extensible Business Reporting Language (XBRL) enabled common platform for listed companies to file their returns with stock exchanges and also a common place for investors to view information related to listed companies.

A new clause viz., clause 52 was introduced in Equity Listing Agreement. This clause requires listed companies to file information with the stock exchanges only through CFDS. The companies, which were mandated to file information through CFDS or were registered on CFDS on their own volition though not so mandated, need not file information through the EDIFAR system. The companies which had commenced filing through CFDS would continue to do so through CFDS only.

Initially 100 companies, jointly selected by BSE and NSE based on market capitalisation were mandated to file through CFDS.

ix. Amendments Pertaining to Issue Process

a) Quoting of PAN Mandatory in Issue Application Form

Prior to the amendment in this regard, all applicants in public and rights issues were required to disclose their PAN/GIR in the application form if they were making an application for a value exceeding Rs. 50,000. The requirement of quoting PAN in application forms was extended to all applicants, irrespective of value of the application. Further, it was clarified that there would be no requirement of attaching

photocopy of PAN card with bid/issue application form.

b) Discount in Issue Price for Retail Investors / Retail Shareholders

Prior to this amendment, SEBI (DIP) Guidelines did not provide for issuance of shares at differential price to investors in the net offer to public category. The amendment made, permitted issuer company to issue shares to retail individual investors /retail individual shareholders at a price lower than that being offered to other categories, provided that such discount does not exceed 10 per cent of the price at which securities were issued to other categories of public.

c) Definition of "Retail Individual Shareholder" for Listed Companies

Prior to this amendment, listed companies making public issues could make reservation on competitive basis for its existing shareholders who, as on the record date, were holding shares worth up to Rs. 50,000. However, no limit was specified on the value of the application that can be made by such shareholders. The definition of the term "Retail Individual Shareholder" was defined to mean a shareholder (i) whose shareholding was of value not exceeding Rs. 1,00,000 as on the day immediately preceding the record date to be determined by the issuer, and (ii) who made application or bids in a public issue for value not exceeding Rs. 1,00,000.

d) Clarification on the Term CEO / CFO

SEBI (DIP) Guidelines required all directors, CEO and CFO of the issuer company to certify that disclosures made in the offer document are true and correct. It was clarified that the terms "CEO" and "CFO" in SEBI (DIP) Guidelines shall have the same meaning as assigned to them in clause 49 of the Equity Listing Agreement.

e) Deletion of the Chapter on "Guidelines for Issue of Capital by Designated Financial Institutions (DFIs)"

In view of DFIs operationally competing on equal footing with private entities, the special dispensations given to DFIs were removed by deleting the chapter on "Guidelines for Issue of Capital by DFIs" from SEBI (DIP) Guidelines.

f) Monitoring of Issue Proceeds

As per erstwhile SEBI (DIP) Guidelines, every issuer making an issue of more than Rs. 500 crore was required to appoint a monitoring agency, which needed to file a monitoring report with SEBI. This provision was amended to provide that it would not apply to (i) issues by banks and public financial institutions and (ii) offers for sale and also that monitoring agency would be required to file its report with the issuer company and not with SEBI. The issuer company would in turn place the report before its Audit Committee.

g) Eligibility of Pledged Shares for Computation of Minimum Promoters' Contribution

Securities which were pledged with banks or financial institutions as collateral security for loans granted by such banks or financial institutions, would not be eligible for computation of minimum promoters' contribution in case of company going for public issue.

x. Amendments to Clause 41 of the Listing Agreement

The revised clause gives an option to the listed companies to furnish either audited or unaudited quarterly and year to date financial results to the stock exchange within one month of end of each quarter (other than the last quarter), subject to the following :

a) In case the company opts to submit unaudited financial results, it shall be subjected to limited review by the statutory auditors of the company (or in case of public sector undertakings, by any practicing Chartered Accountant) and a copy of the limited review report shall be furnished to the stock exchange within two months from end of the quarter.

b) In case the company opts to submit audited financial results, it shall be accompanied by the audit report.

The requirement as to the furnishing of financial results of last quarter was prescribed in the revised Clause.

It also required that explanation for variations be furnished only in respect of net profit or loss after tax and for exceptional / extraordinary items and the percentage of variation for the purpose was revised to "10 per cent or Rs. 10 lakh, whichever was higher".

As regards to the publication of financial results, the companies having subsidiaries which file both stand-alone and consolidated financial results to the stock exchange was given an option to publish either stand-alone or consolidated financial results, subject to the condition that a choice once exercised could not be changed during the year. In case the company changes its option in any subsequent financial year, it should furnish comparative figures for the previous financial year in accordance with the option exercised for the current year.

The revised clause also specified the manner of approval and authentication of the financial results and formats.

xi. Amendments to Clause 49 of the Listing Agreement

The amendment to Clause 49 made provided that where a monitoring agency was appointed, the report submitted by such agency should be placed before the Audit Committee of the issuer company, so as to enable the Audit Committee to make appropriate recommendations to the Board of the issuer company. Further, every issuer company was required to inform material deviations in the utilisation of issue proceeds to the stock exchange and to simultaneously make public the material deviations / adverse comments of the Audit Committee / monitoring agency, through an advertisement in newspapers.

II. Secondary Securities Market

i. Mandatory Requirement of Permanent Account Number (PAN) for All Transactions in the Securities Market

Pursuant to the Hon'ble Finance Minister's announcement in Union Budget: 2007-08, SEBI stipulated that PAN would be the sole identification number for all participants in the securities market, irrespective of the amount of transaction with effect from July 02, 2007.

Market intermediaries were advised to ensure that their clients' transactions are linked to the PAN details of the client with which detailed analysis could be made and to build the necessary infrastructure for enabling accessibility and query based on PAN thereby enabling retrieval of all the details of the clients that was available including the transactions done by them. The objective of the said requirement was to strengthen the 'Know Your Client' (KYC) norms through a single identification number for all participants in the securities market thereby facilitating sound audit trail of all transactions. In accordance with the above mentioned policy, SEBI discontinued with the requirement of Unique Identification Number (UIN) under the SEBI (Central Database of Market Participants) Regulations, 2003 (MAPIN Regulations).

ii. Restrictions on the number of DIS Booklets Withdrawn

In the light of various representations received from investors' associations, restrictions on issuance of Delivery Instruction Slips (DIS) booklets to Beneficial Owners (BOs) were withdrawn.

iii. Short Selling and Securities Lending and Borrowing (SLB)

Hon'ble Finance Minister, in the Union Budget 2007-08, had proposed *inter-alia "to allow short selling settled by delivery, and securities lending and borrowing to facilitate delivery, by institutions."* Subsequently, after a series of discussions with the stock exchanges, depositories and market participants, SEBI specified a broad regulatory framework for short selling and a full-fledged securities lending and borrowing scheme by institutional investors. Relevant amendments were made to SEBI (FII) Regulations, 1995 and SEBI (Mutual Funds) Regulations, 1996, enabling FIIs and Mutual Funds to participate in the framework for short selling and SLB. RBI also made the necessary amendments to Foreign Exchange Management Act, 1999 (FEMA) and vide circular dated January 01, 2008, enabled FIIs to participate in short selling and SLB. Central Board of Direct Taxes (CBDT) vide circular dated February 22, 2008, clarified that SLB transactions would not attract capital gains tax and STT. The aforesaid framework for short selling and SLB would be operationalised with effect from April 21, 2008.

Box 1.2: Short Selling and Securities Lending and Borrowing

Short selling is defined as selling a stock which the seller does not own at the time of trade. The seller would have either borrowed the securities temporarily for delivery to the buyer or would not have made any provision at all i.e. naked short sale.

Short selling is used for many purposes, including to profit from an expected downward price movement, to provide liquidity in response to unanticipated buyer demand, or to hedge the risk of a long position in the same security or a related security. Short selling is considered as a desirable feature as it enhances market efficiency through price discovery and improves liquidity in the permitted securities. Empirical analysis suggests that when short-selling is possible, market returns are less volatile and there is greater liquidity. However, it is also viewed as potential risk than can accentuate a downtrend and thus destabilise the market.

Short selling is central to the theoretical foundations of the Efficient Markets Hypothesis and Asset Pricing theory. Short selling as a trading tool is important from the broad perspective of global equity market development. A recent research study by Cornell University, examines effectiveness of short selling across different types of sellers including individuals, institutions and proprietary accounts. According to the study, heavy short-sellers, mainly institutional, have in fact identified and acted on important value-relevant information that has not yet been impounded into prices. The price effects are permanent, which suggest that short sellers are not manipulating or otherwise temporarily depressing the share price. They found that shorting accounts for more than 12.9 per cent of NYSE volume, suggesting that shorting constraints are easily surmounted for even the smallest-cap NYSE stocks.

The securities markets across the world have permitted short sales subject to certain safeguards like disclosures and tick rules. The US SEC has introduced Regulation SHO in 2005 which was an updated version in light of numerous market developments since short sale regulation was first

Box 1.2: Short Selling and Securities Lending and Borrowing *(Contd.)*

adopted in 1938. Naked short selling is not necessarily a violation of the federal securities laws or the SEC's rules. SEC recognises a tolerance level of unsettled trades for five consecutive settlements, before taking action under SHO.

On the other hand in UK, the Financial Services Authority (FSA) UK, emphasises on transparency and disclosure of short sales rather than putting restrictive rules.

In Hong Kong, short selling is permitted on certain designated securities like those that were part of the benchmark indices or those in which futures and options have been made available. Further, the tick rule has been specified, i.e., it cannot be effected below the best current ask price. At the time of putting the order, investors are required to communicate to broker dealers that it is a short selling transaction.

Many emerging markets like Korea, Japan, Singapore, etc., have also permitted short selling subject to disclosure of such transactions and tick rules. Certain jurisdictions prohibit short selling during specific corporate activities like acquisitions/takeovers, new issuances, strategic policy announcements etc.

In India, short sale was permitted for retail investors in 1996 subject to the disclosure requirements. It was banned twice in 1998 and 2001 in response to market volatility. With the introduction of rolling settlement, with effect from July 2, 2001, SEBI permitted short sales by retail investors. However, institutional investors were not permitted to do the same.

Pursuant to the recommendations of the Secondary Market Advisory Committee (SMAC) of SEBI and the decision of the SEBI Board, it has been decided to permit all classes of investors to short sell. The mechanism for short selling would be supplemented by a full-fledged Securities Lending and Borrowing (SLB) scheme. SEBI has issued guidelines to implement and put in place a broad framework to short-sell and for the introduction of SLB.

Securities Lending and Borrowing (SLB)

Securities lending is a temporary transfer of securities from the owner of the securities to a third party, for a fee. At the end of loan term, securities must generally be returned to the owner. Securities lending arrangements are governed by commercial agreement entered into between the lender and borrower.

Securities lending and borrowing has become an inevitable mechanism in capital markets. SLB complements short selling in securities and also enables the investors to earn returns on their idle securities.

SLB was first introduced in United States in the 1980s. It now supports trading and settlement in all developed and emerging markets. A recent study by World Federation of Exchanges has enumerated how securities lending is affecting the business of stock exchanges through corporate governance norms and market surveillance. SLB confers liquidity and improves efficiency of securities markets. Securities lending provides the lender of securities with a low risk yield enhancement to his portfolio, while enabling the borrower to cover failed trades and to hedge/ arbitrage in the market.

In most markets, the securities lending and borrowing transactions are by and large, over-the-counter (OTC) contractual obligations executed between lenders and borrowers. Regulators do not

Box 1.2: Short Selling and Securities Lending and Borrowing *(Contd.)*

directly regulate the lending and borrowing transactions. In some emerging market jurisdictions like Hong Kong, Korea, Singapore etc., the depositories and custodians provide an electronic platform for execution of securities lending and borrowing transactions. For example the State Street, Bank of New York, Depositories Trust and Clearing Corporation, CrestCo, Korean Securities Depository Association run the SLB for their clients who register with them through electronic trading screen which matches the demand and supply for the designated securities.

In India, SLB was introduced in 1997 with a view to handling settlement shortages. There was no scope for investors to capitalise on the demand for their securities in the market and thus earn a return by lending them. Later, there was a need for a full-fledged SLB to include participation of all classes of investors.

SLB has been introduced by SEBI within the overall framework of Securities Lending Scheme, 1997. All market participants are eligible to participate in the scheme. The SLB takes place on an automated, screen-based, order-matching platform which will be provided by the approved intermediaries (AIs). The AIs includes Clearing Corporation/Clearing House of stock exchanges having nation-wide terminals. The securities traded in F&O segment are eligible for lending & borrowing under the scheme.

References:

1. *Discussion paper on Short Selling and Securities Lending and Borrowing, SEBI.*
2. *Xiaoyan Zhang, Ekkehart Boehmer and Charles M. Jones, "Which Shorts Are Informed?", Cornell University, Journal of Finance, April, 2008.*
3. *The website of Pan-Asia Securities Lending Association (http://www.paslaonline.com) .*
4. *SEC website, http://www.sec.gov .*

iv. Margining of Institutional Trades in the Cash Market

In order to provide a level playing field to all the investors in the cash market as in the case of derivatives market, SEBI mandated that all institutional trades in the cash market would be subject to payment of margins as applicable to transactions of other investors. It was specified that w.e.f. April 21, 2008, trades would be margined on a T+1 basis with margin being collected from the custodian upon confirmation of the trade.

v. Draft SEBI (Investment Advisers) Regulations, 2007

The draft SEBI (Investment Advisers) Regulations, 2007 were placed on the website inviting public comments and suggestions.

vi. Policy for Supervision of Branches of Depository Participants

In terms of Regulation 46 of the SEBI (Depositories and Participants) Regulations, 1996, every Depository Participant (DP) shall have adequate mechanism for the purpose of reviewing, monitoring and evaluating its internal accounting controls and systems. It had been clarified that these provisions apply to DPs in respect of all their branches also. DPs were, therefore, required in terms of these provisions to put in place appropriate mechanisms to ensure that their branches

were carrying on the operations in compliance with the applicable regulations, bye-laws, etc. Further, DPs were also required to put in place suitable internal control systems to ensure that all branches were exercising due diligence in opening accounts, complying with KYC requirements, ensuring systems safety in complying with client instructions, manner of uploading client instructions, verifying signatures and maintaining client records, etc.

Depositories shall examine the adequacy of the above mechanisms during their inspections of DPs. Depositories shall also put in place appropriate mechanisms for monitoring opening of branches by DPs.

vii. Policy Initiatives for Derivatives

a) Derivatives Market Review Committee (DMRC)was set up on April 3, 2007 under the Chairmanship of Professor M. Rammohan Rao to carry out a comprehensive review of the developments in the derivatives market in India and to suggest the future course of action. SEBI on November 14, 2007, approved, in principle, the interim recommendations on 'New products for futures and options segment'. Accordingly, four new derivative products have been introduced. It is expected that these new derivative products will provide investors with a wider range of risk mitigation products and create more activity in the Indian derivatives markets. The four products are as follows:

- **Mini Contracts in equity indices:** Exchanges (NSE and BSE) were permitted to introduce mini contracts in equity indices with minimum contract size of Rs. one lakh. It was expected that the availability of mini contracts with lower contract size i.e. Rs one lakh will facilitate small retail investors to effectively hedge their portfolios. The existing risk containment and other measures applicable for existing exchange traded equity Index derivative contracts were also extended to the mini derivative contract on Index.

- **Options contracts with longer life/ tenure:**
Exchanges (NSE and BSE) were permitted to launch options contracts with longer tenure up to five years. To begin with, at any point in time, there would be options contract with at least three year tenure available for investors. The options cycle would be as under:

➢ The three serial month contracts would continue to exist.

➢ The following three quarterly months of the cycle March/June/ September/December would be available.

➢ After these, five following semi-annual months of the cycle June/ December would be available, so that at any point in time there would be options contract with at least three year tenure available for investors.

The risk containment and other measures applicable for existing exchange traded equity Index option contracts would be extended suitably to long term option contracts on Index.

It was expected that these contracts will provide liquidity at the longer end of the market and will enable investors to hedge their positions for a longer duration.

- **Volatility index and F&O contracts:** Exchanges (NSE and BSE) were

permitted to construct volatility index and disseminate the same. The Exchanges were free to decide whether they want to adopt any of the Volatility Index computation models available globally or may like to develop their own model for computation of Volatility Index. Based on experience gained and awareness generated, derivatives on Volatility Index would be considered for introduction in due course of time.

- **Bond Index and F&O contracts:** Exchanges were permitted to construct the bond index (both corporate and GOI) and disseminate the same. Bond index reflects expectations about the term structure of interest rate in the economy. It was expected that futures and options on bond index will enable market participants to hedge their interest rate risk. The exchanges were free to decide whether they want to adopt any of the Bond Index computation models available globally or may like to develop their own model for computation of Bond Index.

b) SEBI permitted clearing members to accept Foreign Sovereign Securities as collateral from Foreign Institutional Investors (FIIs) for Exchange Traded Derivative Transactions.

Presently, in Exchange traded derivative transactions, FIIs are depositing the collateral with the clearing members, in the form of cash. Under the existing guidelines for clearing members, for collateral purposes, at least 50 per cent of the liquid assets would be in the form of cash or cash equivalents, and the rest can be in the form of non-cash components. Clearing members were now permitted to accept foreign sovereign securities with 'AAA' rating, ("sovereign securities") as collateral from FII client with the following necessary safeguards:

- ➢ Before accepting sovereign securities as collateral from FII, the clearing member would enter into a written agreement with the FII and also with the clearing corporation.
- ➢ The clearing member would take due care to ensure that the sovereign securities tendered as collateral would be available for liquidation in the event of insolvency of the FII or any intermediary or any other person located overseas through whom the securities were held.
- ➢ The clearing corporation would also take due care to ensure that sovereign securities tendered as collateral are available for liquidation in the event of insolvency of the clearing member or any intermediary or other person located overseas through whom the securities were held.
- ➢ The clearing corporation would take adequate care to ensure that the sovereign securities accepted by it as margin were tendered under a mechanism which does not unduly hinder timely liquidation in the event of default by the clearing member.

The clearing corporation would value the collateral tendered by applying due haircuts. The haircut may either be a fixed percentage or VaR based. A higher haircut may be considered to cover the expected time frame for liquidation. A market determined price as obtained from an internationally recognized data vendor shall be considered for valuation. The prices shall be converted into rupee terms on a daily basis. The rupee

value so used for conversion shall be the "RBI Reference rate". The RBI reference rate shall be disclosed by the clearing corporation to the clearing members, so as to enable them to report the value of the margins collected from FIIs.

The sovereign securities tendered as collateral shall be treated as part of the cash component of the liquid assets of the clearing member, and shall be subject to the condition that the value of the sovereign securities shall not be more than 10 per cent of the total value of the cash component of the liquid assets of the clearing member.

The existing procedure for acceptance and release of collateral tendered by domestic investors in the case of domestic securities shall be adopted *mutatis mutandis* for the sovereign securities tendered by FII, except to the extent specifically provided otherwise.

viii. Corporatisation and Demutualisation (C and D) of Stock Exchanges

The Securities Contracts (Regulation) Act, 1956 (SCRA) was amended in October 2004 to facilitate the Corporatisation and Demutualisation of stock exchanges, mandating all recognised stock exchanges, if not already corporatised and demutualised,

Box 1.3: New Derivatives Products

India is presently reckoned as one of the most established markets in the world for exchange traded derivatives products. In order to further deepen the derivatives market and to cater to the growing needs of investors for more sophisticated derivatives products, SEBI decided to come up with three new products i.e. mini contracts, option contracts with longer life/tenure and volatility Index. The three products would provide investors more flexibility in terms of executing their trading strategies.

Mini derivative contracts would enable small investors with a small exposure in the cash market, to hedge their positions. Initially, mini index futures and options, namely, on Sensex and S&P CNX Nifty, with a minimum contract size of Rs. one lakh has been introduced. Chicago Mercantile Exchange provides a wide range of E-mini futures contracts on indices like Nasdaq 100, S&P 500, S&P MidCap 400 and Russell 2000. For example, E-mini S&P 500 futures contract is one-fifth of the size of standard S&P 500 futures contract.

Presently, exchange traded equity options contracts have a maximum life of three months. It was felt that longer duration/tenure option contracts would enable investors to take a view on prolonged price changes without needing to use a combination of shorter term option contracts or to roll over several short-term contracts. Long-term options have been introduced with expiration dates upto three years, on indices namely, Sensex and Nifty. Longer term equity option contracts were introduced in 1993 as LEAPS (long-term equity anticipation securities) by Chicago Board of Options Exchange (CBOE) on S&P 100, S&P 500 and Russell 2000 with an expiration time upto three years. Montreal Exchange at Canada also lists long term equity options with an expiration time upto three years.

Volatility Index is a measure of market expectations of near term volatility conveyed by the prices of stock index options or a basket of options on stocks. The volatility index is considered to be a kind of indicator of investor sentiment, with high values implying pessimism and low values implying optimism.

Box 1.3: New Derivatives Products *(Contd.)*

Volatility Index provides a series of snapshots of expected stock market volatility over a specified time period. The Volatility Index is calculated in real-time and gets continuously disseminated throughout each trading day. Investors also use the implied volatility information given by the index, in identifying mis-priced options. In 1993, the Chicago Board Options Exchange (CBOE) introduced the CBOE Volatility Index (VIX) which became the benchmark for stock market volatility. CBOE has a family of derivative products based on this index as well. The CBOE VIX is an implied volatility index that measures the market's expectation of 30-day S&P 500 index volatility implicit in the prices of near-term S&P 500 index options.

A volatility index would help investors to take a view on the near term volatility changes in the securities market. It is increasingly felt that an openly available and quoted measure of market volatility in the form of an index would help market participants to hedge the risk arising out of changing volatility.

The exchanges in India may choose any of the volatility index computation models available globally or would like to develop their own model for computation of volatility index. The detailed methodology for computing the volatility index shall be disseminated by the exchange for the benefit of the market participants and investors. Depending on the experience gained and inputs generated, derivatives on volatility index would be considered for introduction in future.

References:

1. *"Note on New Products in F&O Segment", Reports for Public Comments, December 17, 2007, SEBI website: www.sebi.gov.in.*
2. *Computational Methodology of India VIX, National Stock Exchange of India Ltd. website: www.nseindia.com.*
3. *"Exchange Traded Equity Options Come of Age", Carol Bere, Global Finance, June 1998.*
4. *Reference Manual, Equity Options, Montreal Exchange, Canada.*

to be corporatised and demutualised on and from the appointed date as notified by SEBI. It obligated on all non-corporate and mutual stock exchanges to submit their C and D Scheme to SEBI for approval.

SEBI notified C and D schemes of 19 stock exchanges in the year 2005. As per the C and D schemes, the stock exchanges were required to complete their corporatisation process within three months from the date of notification of their respective Schemes.

The process of corporatisation includes incorporation of for-profit company limited by shares, re-registration / conversion from company limited by guarantee to company limited by shares, allotment of shares to eligible members, etc. Accordingly, all the stock exchanges were converted into corporate entities in the year 2006-07.

In order to fully complete their demutualisation process, the stock exchanges were required to ensure that at least 51 per cent of their equity share capital is held by public other than shareholders having trading rights as per section 4B (8) of the SCRA. The stock exchanges were required to complete the same within twelve months from the

publication of the Order, approving their respective schemes (further extendable by SEBI by another period of twelve months as per the SCRA). As requested by the stock exchanges, SEBI extended the above time period by another period of twelve months for all 19 stock exchanges.

To facilitate the divestment process, SEBI notified the Securities Contracts (Regulation) (Manner of Increasing and Maintaining Public Shareholding in Recognised Stock exchanges) Regulations, 2006 (MIMPS Regulations) on November 13, 2006. Subsequently, the Government of India policy regarding foreign investments in infrastructure companies in securities markets, viz. stock exchanges, depositories and clearing corporations was issued by SEBI on December 22, 2006. In conformity with the provisions of the MIMPS Regulations and the aforesaid FDI policy, 16 stock exchanges had completed their demutualisation process by diluting at least 51 per cent of their equity shareholding to public other than shareholders having trading rights. Appointed dates were also notified for these stock exchanges.

As for the remaining three stock exchanges, SEBI withdrew the recognition of Saurashtra Kutch Stock Exchange Limited and Magadh Stock Exchange Limited for failing to comply with observations in the inspection report and Hyderabad Stock Exchange Limited was de-recognised for its failure to complete the demutualisation process within the prescribed time.

As part of the aforesaid divestment process, in all 521 investors (146 corporates and 375 individuals) had subscribed to the equity share capital of 16 stock exchanges. The 146 corporates who had taken stake in various stock exchanges include 43 listed companies. Some of the major banks/ institutions that had taken stake in various stock exchanges include State Bank of India, Central Bank of India, Bank of India, Life Insurance Corporation of India, TIDCO and WBIDFC.

The aforesaid 521 investors include six foreign entities that had taken stake in Bombay Stock Exchange Limited namely Deutsche Boerse A.G., Singapore Exchange Limited, Caldwell India Holdings Inc, Atticus Mauritius Ltd, Dubai Financial LLC and Acacia Banyan Partners Ltd. In the case of Delhi Stock Exchange Association Limited, three foreign entities had taken stake viz., New Vernon Pvt. Equity Ltd., Passport Global Master Fund SPC Ltd., and Wilmette Holdings Ltd. Though NSE was already incorporated as a demutualised exchange, eight foreign stakeholders namely, NYSE Group, Inc. New York, GA Global Investments Limited, Cyprus, GS Strategic Investments Limited, Mauritius, SAIF II Mauritius Company Limited, Mauritius, Saturn India Limited, Mauritius, Saturn South Asia Limited, Mauritius, Citigroup Strategic Holdings Mauritius Limited, Mauritius and MS Strategic (Mauritius) Limited, Mauritius had equity stake in NSE as on March 31, 2007.

III. Corporate Debt Market

i. Reporting Platforms for Corporate Bonds

a) Earlier, during 2006-07, SEBI had permitted BSE and NSE to set up reporting platforms for corporate bonds to capture all information related to trading in corporate bonds as accurately and as close to execution as possible. The platforms were put in place since January 01, 2007 and March 01, 2007, respectively. In addition to the existing reporting platforms being operated by BSE and NSE, SEBI granted approval to FIMMDA for starting a similar corporate bond trade reporting platform. The platform subsequently became operational in September 2007.

b) In August 2007, SEBI started placing information on secondary market trades (both exchange and OTC trades) on its website on the basis of data provided by the two stock exchanges, BSE and NSE and also information from FIMMDA.

ii. Trading Platform for Corporate Bonds

a) The High Level Committee on corporate bonds and securitisation chaired by Dr. R. H. Patil had recommended that trade reporting be followed by development of online order matching platforms for corporate bonds with clearing and settlement.

b) SEBI permitted BSE and NSE to put in place corporate bond trading platforms with effect from July 01, 2007, to enable efficient price discovery and clearing and settlement in a gradual manner.

c) To begin with, the trade matching platform would be order driven with essential features of OTC market. BSE and NSE were advised to make use of the existing infrastructure available with them for the purpose with necessary modifications.

d) On stabilisation of the trade matching system, exchanges may move towards anonymous order matching for trading of bonds within an appropriate period of time.

e) Though, in the initial stages, entities may settle their trades bilaterally, the stock exchanges would provide clearing and settlement facilities and multilateral netting upon subsequent introduction of anonymous order matching platform.

iii. Issues in Trading in Corporate Bonds Addressed

a) The Patil Committee, in its report had made recommendations on reduction of shut period and introduction of mandatory standard day count convention for all new issuances. It was suggested that the day count convention be introduced on a 30/360 basis and eventually moved towards actual/actual basis.

b) Also, the said committee had recommended that the minimum market lot criteria of Rs.10 lakh for trading in corporate bonds at the stock exchanges should be reduced to Rs. one lakh to enable better access to smaller investors.

c) Accordingly, stipulations were prescribed such as:

- Reduction the shut period in corporate bonds to align it with norms for shut period that are currently applicable for Government Securities.
- Reduction of tradable lots in corporate bonds in respect of all entities including Institutional Investors to Rs. one lakh. The stock exchanges were advised to have a limited segment for transactions for smaller market lots.
- Introduction of mandatory actual day count convention for all new issues of corporate bonds as is followed in respect of dated Government Securities.

iv. Amendments to the Listing Agreement for Debentures

a) In April 2007, in line with the recommendations made by the Patil Committee to improve transparency, SEBI made amendments to the listing agreement for debentures to ensure that services of ECS (Electronic Clearing Service), Direct Credit, RTGS (Real Time Gross Settlement) or NEFT (National

Box 1.4: Corporate Bond Market

The development of debt market has a significant bearing on a country's economic development and its ability to withstand shocks and crises. The debt market supplements the banking system to meet the requirements of the corporate sector for long-term capital investment and asset creation. It provides a stable source of finance when the equity market is volatile and works as an alternative source of finance. It is essential that the government securities market and corporate debt market grow side by side, preferably at a desired rate. Further, it is also advisable to keep the level of total debt within a sustainable limit and the cost composition and risk profiles are managed efficiently.

There are various means of mobilising funds in capital market which include debt issue, public issue, private placement, preferential allotment etc. Bonds, particularly longer tenure ones, are attractive for long-term, large-scale borrowing to finance fixed assets and investments.

The corporate bonds can be issued by way of private placements and public offerings. The issuers in these categories are the corporate entities, public financial institutions, banks, public sector undertakings, state owned enterprises etc. Major instruments of mobilising funds include partly/ fully convertible debentures, deep discount bonds, zero coupon bonds, floating rate notes and secured premium notes.

In developed countries, corporate debt market is as developed as the securities market. In USA, the corporate debt market has supplemented the market for Treasury securities by increasing issuance sizes of bonds and periodic regularity to appeal to investor demand. Corporate debt is primarily used as a benchmark to monitor the performance of the market and to evaluate other outstanding corporate debt securities and assist in pricing of new corporate debt issues. In Korea, as well the limited supply of government bonds has been supplemented by dominance of corporate debt issues.

India has a very well developed government securities market similar to other developed countries in the world. However, in India the corporate bond market has been lagging behind the government securities market in terms of market infrastructure, trading facilities, number of market participants, etc. Recently, some important measures have been undertaken to develop the corporate bond market in India.

SEBI granted permission to BSE and NSE to set up trading and reporting platforms to capture all information related to trading in corporate bonds. Non-members of the Exchange were, however, provided connectivity through Virtual Private Network (VPN). Later, Fixed Income Money Market and Derivatives Association of India (FIMMDA) was permitted to start Corporate Bond Trade Reporting Platform. The trade matching platform is now order driven with essential features of OTC market. SEBI decided that a system of anonymous order matching shall be established gradually. BSE and NSE provide data pertaining to corporate bonds comprising issuer name, maturity date, current coupon, last price traded, last amount traded, last yield (annualised) traded, weighted average yield price, total amount traded and the rating of the bond and any other additional information. To reduce information asymmetry, the two exchanges co-ordinate among themselves, check for redundancy and disseminate information on their websites in a homogenous manner. BSE and NSE provide their services for clearing and settlement of corporate bonds traded. The shut period in corporate bonds has been reduced to align it with that applicable for Government Securities. Tradable lots in corporate bonds have been reduced for all the entities. It has been made mandatory for all new issues of corporate bonds to have an actual day count convention.

Box 1.4: Corporate Bond Market *(Contd.)*

To facilitate clearing and settlement, amendments were made to the listing agreement for debentures to ensure that services of ECS (Electronic Clearing Service), Direct Credit, RTGS (Real Time Gross Settlement) or NEFT (National Electronic Funds Transfer) are used for payment of interest and redemption amounts.

In context of repos in corporate bonds, SEBI has requested RBI to initiate action as required. BSE and NSE confirmed their preparedness for going in for introduction of repos in corporate bonds.

Honourable Finance Minister in his Budget speech of 2008-09 has proposed to expand the market for corporate bonds. These includes certain measures such as,

- *taking measures to develop the bond, currency and derivatives markets that will include launching exchange-traded currency and interest rate futures;*
- *developing a transparent credit derivatives market with appropriate safeguards;*
- *enhancing the tradability of domestic convertible bonds by putting in place a mechanism that will enable investors to separate the embedded equity option from the convertible bond and trade it separately; and*
- *encouraging the development of a market-based system for classifying financial instruments based on their complexity and implicit risks.*

Honourable Finance Minister also announced that corporate debt instruments issued in demat form and listed on recognised stock exchanges will be exempted from TDS.

Electronic Funds Transfer) are used for payment of interest and redemption amounts as per applicable norms of RBI along with other existing facilities.

b) In April 2007, SEBI made amendment to the listing agreement for debentures to ensure that no material modification shall be made to the structure of the debentures issued in terms of coupon, conversion, redemption or otherwise without prior approval of the stock exchanges where they are listed. The stock exchanges would also ensure that such information relating to modification or proposed modification is disseminated on the exchange website.

v. Securitised Debt Instruments Regulations

a) In June 2007, draft Regulations for "Public Offer and Listing of Securitised Debt Instruments" was put up on SEBI website for public comments.

b) The draft provides for a system of special purpose distinct entities which could offer securitised debt instruments to the public or could seek listing of such instruments.

c) Other items covered by the draft Regulations include structure for the special purpose entity, conditions for assignment of debt or receivables, procedure for launching of schemes, obligation to redeem, credit enhancement, conditions for appointing servicers, procedure for public offer and listing, rights of investors, inspection and disciplinary proceedings and action in case of default.

vi. Policy on Debenture Trustees

a) The Patil Committee had made

recommendations on strengthening the role of debenture trustees and ensure improved information flow on ratings, defaults, etc., and other information/ reports, including compliance reports filed by the companies and by the debenture trustees by making them public.

b) In August 2007, SEBI made mandatory that the companies issuing debentures and the respective debenture trustees/ stock exchanges shall disseminate all information regarding the debentures to the investors and the general public by issuing a press release and also displaying the details on their respective websites, in the event of:

- Default by issuer company to pay interest/redemption amount;
- Failure to create a charge on the assets; and
- Revision of rating assigned to the debentures.

c) SEBI also made it mandatory to make public, information/reports on debentures issued including compliance reports filed by companies and debenture trustees by placing them on websites of the companies and the debenture trustees. The same is also to be submitted to stock exchanges for dissemination through their websites.

vii. Road towards Repos

a) The Patil Committee had placed emphasis on introduction of repos in corporate bonds by RBI in order to improve secondary market trading. It was also of the view that this would give an opportunity to investors who have illiquid corporate bonds to recycle the same and borrow money against these securities.

b) RBI was of the view that appropriate system for Delivery versus Payment (DvP) III based clearing and settlement system, active secondary market trading for fair price and Straight Through Processing (STP) needs to be put in place. SEBI had initiated necessary steps for early introduction of Repos in corporate bond market and involved closely with RBI, exchanges and clearing corporations in this regard.

viii. Quote Dissemination Platforms

a) SEBI had received proposals from I-CAP India Pvt. Ltd., a SEBI registered stock broker and also from other entities like Bloomberg, Reuters, etc., and subsequently Derivium Capital, seeking no-objection to establish electronic systems to facilitate OTC trades.

b) Since there was no specific provision for SEBI to either permit or reject such proposals, letters indicating no objection were issued to ICAP, Bloomberg and Reuters in November 2007 and to Derivium capital in February 2008.

c) The systems would help display of buy-sell quotes of counter parties involved so that the buyers and the sellers in the corporate bond market could strike deals at best prices before they go in for order matching either at the exchange or bilaterally.

ix. Simplifying Issuance Norms

SEBI amended the provisions pertaining to issuances of corporate bonds under the SEBI (Disclosure and Investor Protection) Guidelines, 2000. The changes to the guidelines were as below:

a) For public/ rights issues of bonds, issuers now need to obtain rating from only one credit rating agency instead of from two, so as to reduce the cost of issuances.

b) In order to facilitate issuance of below investment grade bonds to suit the risk/ return appetite of investors, the stipulation that debt instruments issued through public/ rights issues would be of at least investment grade was removed.

c) Further, in order to afford issuers with desired flexibility in structuring of debt instruments, structural restrictions such as those on maturity, put/call option, on conversion, etc., were removed.

x. Draft Issue and Listing Regulations

a) In January 2008, draft Regulations on Issue and Listing of Debt Securities were framed and placed on the website along with a consultative paper for comments.

b) Salient features of the draft regulations include: (i) rationalisation of disclosure requirements, and (ii) enhanced responsibilities of merchant bankers for exercising due diligence and mandatory listing of private placement of debt by companies which were earlier not listed.

The paper also makes provisions for e-issuances of corporate debt and proposes introduction of rationalised listing requirements for debt of a listed issuer.

IV. Mutual Funds

i. Parking of Funds in Short-term Deposits of Scheduled Commercial Banks by Mutual Funds – Pending Deployment

In order to ensure that the funds collected in a scheme are invested as per the investment objective stated in the offer document, SEBI issued guidelines for parking of funds in short-term deposits of scheduled commercial banks – pending deployment. The following were some of the features of the guidelines:

a) "Short-Term" for such parking of funds by mutual funds would be treated as a period not exceeding 91 days.

b) No mutual fund scheme would park more than 15 per cent of the net assets in short-term deposit(s) of all the scheduled commercial banks put together. However, it may be raised to 20 per cent with prior approval of the trustees. Also, parking of funds in short-term deposits of associate and sponsor scheduled commercial banks together would not exceed 20 per cent of total deployment by the mutual fund in short-term deposits.

c) No mutual fund scheme would park more than 10 per cent of the net assets in short-term deposit(s), with any one scheduled commercial bank including its subsidiaries.

d) Asset Management Company (AMC) would not be permitted to charge any investment management and advisory fees for parking of funds in short-term deposits of scheduled commercial banks in case of liquid and debt oriented schemes.

It was clarified that the tenure of the term deposits placed as margin for trading in derivatives shall not exceed 182 days.

ii. Reduction in Filing Fees for Offer Documents and Deployment of Funds in Short-Term Deposits of Scheduled Commercial Banks

Filing fees for offer documents i.e. 0.03 per cent of the amount raised in the new fund offer (NFO), subject to a minimum of Rs. one lakh and a maximum of Rs. one crore along with pending deployment of funds of a scheme in terms of investment objectives of the scheme was notified on April 16, 2007. However, vide Gazette Notification dated March 31, 2008, filing fees for offer

documents was further reduced to 0.005 per cent of amount raised in New Fund Offer (NFO) subject to minimum Rs. one lakh and maximum Rs. 50 lakh w.e.f. April 01, 2008. Also, the registration fees payable by the mutual funds was also reduced to Rs. 25 lakh in place of Rs. 50 lakh earlier.

iii. Extension of Time for Uploading of NAVs of Fund of Fund Schemes

In view of the practical difficulties being faced by the mutual funds in uploading the NAV of Fund of Fund schemes on AMFI's website and their own website, it was decided that the time limit for uploading of NAV for fund of fund schemes would be extended to 10:00 am the following business day. In view of this, the NAVs of these Schemes would appear in the newspapers with one day time lag. The published NAV's would be made available with an asterix explaining that the NAVs were with one day/ or the actual time lag. All delays beyond 10:00 am would be reported to AMFI and SEBI as already stipulated.

iv. Bi-monthly Compliance Test Reports (CTRs)

With an objective of effective and relevant disclosure to SEBI, it was decided that instead of filing complete CTR with SEBI, the AMCs shall only do exceptional reporting on a bi-monthly basis i.e., the AMCs would report for only those points in the CTR where it had not complied with the same. This exception report would also be placed before the board of trustees.

v. Investment in ADRs/ GDRs/ Foreign Securities and Overseas ETFs by Mutual Funds

The aggregate ceiling for overseas investments by mutual funds was raised to USD four billion and subsequently to USD five billion as an industry vide ceiling and within this overall limit, mutual funds can make overseas investments subject to a maximum of USD 300 million. The permissible investments in which overseas investments could be made by mutual funds were expanded. Accordingly, a mutual fund can invest in the following:

a) ADRs/ GDRs issued by Indian or foreign companies;

b) Equity of overseas companies listed on recognised stock exchanges overseas;

c) Initial and follow-on public offerings for listing at recognised stock exchanges overseas;

d) Foreign Debt Securities in the countries with fully convertible currencies, short-term as well as long-term debt instruments with rating not below investment grade by accredited/ registered credit rating agencies;

e) Money market instruments rated not below investment grade;

f) Repos in the form of investment, where the counterparty was rated not below investment grade; repos would not, however, involve any borrowing of funds by mutual funds;

g) Government securities where the countries were rated not below investment grade;

h) Derivatives traded on recognised stock exchanges overseas only for hedging and portfolio balancing with underlying as securities;

i) Short-term deposits with banks overseas where the issuer was rated not below investment grade; and

j) Units/securities issued by overseas mutual funds or unit trusts registered with overseas regulators and investing in (a) aforesaid securities, (b) Real Estate Investment Trusts (REITs) listed in recognised stock exchanges overseas

or (c) unlisted overseas securities (not exceeding 10 per cent of their net assets).

vi. Reduction in Expenses charged by Index Fund Scheme

a) The limit on investment and advisory fee for index fund schemes was reduced to 0.75 per cent of weekly average net assets and the total expenses of the scheme including the investment and advisory fees to 1.5 per cent of the weekly average net assets.

b) The reduced expenses and investment and advisory fees was made applicable to exchange traded index funds also.

vii. Short Selling and Securities Lending and Borrowing (SLB)

Enabling provisions were made for a mutual fund to engage in short selling of securities as well as lending and borrowing of securities vide notification dated October 31, 2007. However, these amendments would come into effect only after new framework for short selling and SLB is put in place.

viii. Waiver of Load for Direct Applications

Keeping in view the interest of the investors, it was decided that no entry load should be charged for direct applications received by the asset management company (AMC) i.e., applications received through the internet, submitted to AMC or collection centre/ Investor Service Centre that were not routed through any distributor/ agent/ broker. This would be applicable for investments in existing schemes with effect from January 04, 2008 and in new schemes launched on and after the said date. It would also be applicable to additional purchases done directly by the investor under the same folio and switch-in to a scheme from other schemes, if such a transaction was done directly by the investor.

ix. Removal of Initial Issue Expenses

Previously close-ended schemes were permitted to charge initial issue expenses and not to charge entry load. In order to bring in more transparency and clarify to the investors in terms of the expenses charged to them in close-end schemes, SEBI Board decided that:

a) Henceforth, there would not be any provision of charging initial issue expenses and amortization of the same.

b) All mutual fund schemes would now meet the sales, marketing and such other expenses connected with sales and distribution of schemes from the entry load.

x. Standard Warning in Advertisements by Mutual Funds

The rapid fire manner in which the standard warning "Mutual Fund investments are subject to market risks, read the offer document carefully before investing" recited in the audio visual and audio media rendered it unintelligible to the viewer/ listener. In order to improve the manner in which the said message was conveyed to the investors, it was decided in consultation with AMFI that with effect from April 1, 2008:

a) The time for display and voice over of the standard warning be enhanced to five seconds in audio visual advertisements; and

b) In case of audio advertisements, the standard warning would be read in an easily understandable manner over a period of five seconds.

xi. Revised Format of New Scheme Report

In light of the recent policy developments on account of waiver of entry load for direct applicants and removal of initial issue expense, format of the New Scheme Report was revised.

xii. Load on Bonus Units and Units Allotted on Reinvestment of Dividend

The practice of charging entry load on bonus units issued to unit holders by mutual funds was taken up with AMFI. Based on the recommendations of AMFI Working Group on Standardisation of Key Operational Areas, it was decided that AMCs would not charge entry as well as exit load on bonus units and on units allotted on reinvestment of dividend.

xiii. Dedicated Infrastructure Funds

Finance Minister in his Budget speech for 2007-08, announced that to promote the flow of investment to the infrastructure sector, mutual funds would be permitted to launch and operate dedicated infrastructure funds. In order to suggest a detailed action plan to operationalise the Budget announcement, SEBI set up a four member Committee under the Chairmanship of Shri U. K. Sinha (CMD, UTI AMC).

xiv. Real Estate Mutual Funds

The first guidelines for Real estate Mutual funds were approved by the SEBI in June 2006. A real estate mutual fund scheme refers to mutual fund which has investment objective to invest directly or indirectly in real estate asset and would be governed by the provisions and guidelines under SEBI (Mutual Funds) Regulations, 1996. During 2007-08, steps were taken to address residual issues in discussion with AMFI, ICAI and Credit Rating Agencies. The necessary amendments to the SEBI (Mutual Fund), Regulations 1996, were thereafter notified on April 16, 2008.

xv. Simplification of Offer Documents

Presently Offer Documents (OD) and Key Information Memorandum (KIM) of mutual fund schemes are prepared as per format prescribed by SEBI. It was felt that due to regulatory and other changes over a period of time, the ODs not only became lengthy and complex but also highly technical and legalistic. Consequently, ODs appeared to have become less-user friendly. SEBI in consultation with AMFI is working on the modalities for simplification of OD. The simplified version of OD would help the investor in making investment decision by concentrating on the scheme specific details.

V. Foreign Institutional Investors

During 2007-08, SEBI took various initiatives addressing issues relating to registration of FIIs and sub-accounts, the issuance of P-Notes/ODIs by FIIs/Sub-accounts. The important measures are detailed below:

i. Registration of FII/Sub-Accounts

a) The “broad-based” criteria to be modified to include entities having at least 20 investors, with no single investor holding more than 49 per cent (instead of 10 per cent at present).

b) Track record of individual fund managers to be considered for the purpose of ascertaining the track record of a newly set up fund, subject to such fund manager providing disciplinary track record details.

c) FII and sub-account registrations to be perpetual, subject to payment of fees and requirement of renewal was removed.

ii. Issuance of Participatory Notes (P-Notes)

a) FIIs/ Sub-accounts were prohibited from issuing new Offshore Derivative Instruments (ODIs) with derivatives as underlying and existing positions with regard to such ODIs to be wound up over 18 months.

b) Sub-accounts were barred from issuing new ODIs with existing sub-accounts

required to wind up outstanding instruments within 18 months.

c) With a view to capping the volume of outstanding P-Notes/ODIs, following measures were introduced:

- Those FIIs currently issuing ODIs with notional value of ODIs outstanding (excluding derivatives) as a percentage of their AUC in India of less than 40 per cent would be allowed to issue further ODIs only at the incremental rate of 5 per cent of their AUC in India.
- Those FIIs with notional value of ODIs outstanding (excluding derivatives) as a percentage of their AUC in India of more than 40 per cent shall issue ODIs only against cancellation / redemption / closing out of the existing ODIs of at least equivalent amount.
- The effective date for calculation of the AUC for the purpose of determining the notional value of ODIs issued as a percentage of AUC, for the above proposals would be September 30, 2007.

d) Issuance of PNs/ODIs would be limited to only "regulated" entities and not "registered" entities.

iii. Change in Investment Limit in Debt Securities

The investment limit for FIIs in Government Securities (including Treasury Bills) was enhanced from USD 2.6 billion to USD 3.2 billion. It was decided that investments by FIIs/Sub-Accounts in debt oriented mutual fund units (including units of money market and liquid funds) would be considered as corporate debt investments and reckoned within the stipulated limit of USD 1.5 billion, earmarked for FII/Sub-Account investments in corporate debt. The following would be applicable in this regard:

a) There should be no demarcation between 100 per cent debt and normal

Box 1.5: Participatory Notes

Participatory Notes are instruments that derive value from underlying securities such as equity and equity linked instruments. It allows FIIs including financial institutions, endowment funds, hedge fund, private equity and other entities for taking exposure in the Indian market without registered with SEBI as FII or a su- account.

Participatory Notes not only give foreign investors access to domestic markets, but also the identity of the actual investor and source of funds could remain disguised.

After globalisation in 1992, when FII were allowed to invest in Indian securities market, an offshore market for PN developed as a primary channel for the foreign investor to invest in India. Thus India's stock market has witnessed a huge boom in recent years, much of which has been supplied by FIIs flows. The total investment in Indian markets by FII was almost USD 68 billion as of March 31, 2008 compared to USD 52 billion in March 2007. There has been a parallel rise in the popularity of P-Notes.

Keeping in mind the need to move in right direction towards international best practices and more stable, transparent securities markets in India, SEBI felt that it is in the long-term benefit of the market, flow of funds through P-Notes need to be transparent.

70:30 FIIs/Sub-Accounts for the purposes of allocation of debt investment limits. The individual limits allocated to the 100 per cent debt FIIs/Sub-Accounts stood cancelled.

b) The allocation of unutilised/unallocated limits for investment in Government Securities/T-Bills would be on first-come-first-serve basis.

VI. Rationalisation of Fee Structure

A committee under the chairmanship of former Whole Time Member Shri V. K. Chopra was set up to examine SEBI's fee structure for rationalization. Based on the recommendations of the committee, SEBI fee was reduced ranging from 50 per cent to 90 per cent for filing of offer document for public/rights issue, offer document under SEBI takeover and buy-back of securities, offer document for mutual fund schemes, ad-valorum fee charged on assets under custody of custodians and registration fee for venture capital funds.

VII. Investor Assistance and Investor Education (OIAE)

i. Redressal of Investors' Grievances

The Office of Investor Assistance and Education was mandated as the single window interface for receiving grievances from investors. Investors could submit to OIAE for redressal of the grievances that they may have against intermediaries or listed companies at any of the four offices of the SEBI i.e. Head Office at Mumbai and the three Regional Offices at Delhi, Chennai and Kolkata, irrespective of the location of the intermediary/ listed company. SEBI had put in place a comprehensive mechanism for dealing with investor grievances. OIAE facilitates redressal of the grievances of investors by taking up these grievances with the respective listed companies.

While the standardised paper based formats common for all types of complaints was freely available at all the offices of SEBI and on the SEBI websites, grievances from investors were accepted in any form i.e. a plain paper, on a post card, via e-mail etc. SEBI website also offers investors the facility of checking the status of their complaints lodged with SEBI.

Dedicated investor helpline numbers were made available for investors to call for guidance that they may require in their dealings in the securities market and assistance in filing grievances. Dedicated personnel, manning the helpline, guided investors in filling the grievance submission forms as well as determining the appropriate authority for their first recourse in case of a grievance. Guidance was also provided to approach the appropriate authority if their grievance is outside the purview of SEBI.

The grievances lodged by investors were taken up with the respective listed companies and registered intermediaries. Status of the grievances taken up with the companies and the intermediaries was continuously monitored and regular follow-up action was determined based on the response received from the companies and intermediaries.

During 2007-08, SEBI received 54,933 grievances from the investors of which 31,618 grievances were resolved as compared to 26,473 grievances received from investors and 17,899 complaints resolved in 2006-07. A total of 1,89,409 grievances were pending resolution as on March 31, 2008 as compared to 1,66,152 complaints pending as on March 31, 2007.

Types of investors' grievances received and redressed, as on March 31, 2008, are given in the Table 1.4 whereas type-wise status of complaints awaiting redressal is provided in Table 1.5.

Table 1.4: Status of Investor Grievances Received and Redressed

Year	Complaints Received	Complaints Redressed	Complaints Pending
2005-06	40,485	37,067	1,57,520
2006-07	26,473	17,899	1,66,094 *
2007-08	54,933	31,618	1,89,409

* After updating figures for physical and computerised database.

Penalties had been levied on the following two companies for non-resolution of investors' grievances under Section 15C during 2007-08:

- Pentafour Solec Technology Ltd. - Rs. three lakh; and
- Southern Herbals Ltd. - Rs. five lakh.

ii. Business Reply Post Card Exercise

An exercise was conducted wherein pre-paid post cards were sent to 27,319 investors whose grievances had been treated as resolved based on the action informed by the respective companies. Confirmations were sought from these investors whether the grievances were actually resolved. Cases where investors indicated the grievances as yet unresolved were reopened and matter was taken up vigorously with the concerned companies.

iii. Issuance of No-Objection Certificate (NoC)

At the time of making public/rights issues, companies have to deposit an amount equivalent to one per cent of the issue value

Table 1.5: Type-wise Status of Complaints Awaiting Redresssal

Type	Particulars	Pending as on March 06	Pending as on March 07	Pending as on March 08
1	2	3	4	5
I	Non-receipt of refund orders / allotment letters etc.	4,234	4,793	18473
II	Non-receipt of dividend	7,176	7,969	8474
III	Non-receipt of share certificates / bonus shares	23,563	24,551	25,393 *
IV	Non-receipt of debenture certificates etc.	7,111	7,333	7,015
V	Non-receipt of interest on delayed payment of refund orders etc.	1,317	1,557	2,293
VI	Complaints related to collective investment schemes	1,08,837	1,09,525	1,09,076
VII	Complaints related to Mutual funds, FIIs, Custodians etc.	634	900	1,766
VIII	Complaints related to brokers, Sub-brokers, Merchant bankers etc.	4,334	8,680	15,119
IX	Complaints related to Stock Exchanges, Depositories etc.	42	161	264
X	Complaints related to Derivative Exchanges etc.	0	23	24
XI	Complaints related to takeovers, buyback, Delisting etc.	272	602	1,512
	Total No. of Grievances awaiting redressal	**1,57,520**	**1,66,094**	**1,89,409 ****

* Includes grievances of demat credit not received in IPO/FPO.

** In 1,33,354 cases action has been initiated u/s 11B and 15C or Prosecution launched.

with a stock exchange designated for the purpose. To release this amount, an application had to be made to SEBI four months after the date of listing for issuing a NoC letter to the exchange. OIAE processes this application and ensures that investors' grievances received by SEBI were addressed by the concerned companies satisfactorily before issuance of NoC.

In 2007-08, 49 NoCs were issued to applicant companies. In 12 cases, NoCs were yet to be issued due to non-submission of required documents by the companies or an unsatisfactory record of redressal of investor grievances on their part.

iv. Investors' Associations

OIAE also recognises representatives of investors in the form of investors associations. SEBI had collaborated with these investors' associations, which had interest of investors, to spread the message of "Invest with knowledge" to the investing public. The inputs, view and opinions of these associations were considered for policy formulation.

SEBI continued its attempts to approach new bodies working for the welfare of consumers/investors to get recognition as Investors' Associations with itself. As on March 31, 2008, 21 Investors' Associations had been granted recognition by SEBI:

1. All Gujarat Investor Protection Trust, Ahmedabad
2. Citizens Awareness Group ,Chandigarh
3. Coimbatore District Consumers Protective Council, Coimbatore
4. Consumer Education and Research Society, Ahmedabad
5. Consumers' Guidance Society, Vijaywada
6. Consumer Rights, Education and Awareness Trust, Bangalore
7. Consumer Unity and Trust Society, Jaipur
8. Federation of Consumer Associations, West Bengal, Kolkata
9. Ganga Jamuna, New Delhi
10. Investor Education and Welfare Association ,Mumbai
11. Investors Grievances Forum ,Mumbai
12. Karimpur Social Welfare Society, Karimpur
13. Kolhapur Investors' Association, Kolhapur
14. Mizoram Consumers' Union ,Aizwal
15. Lokmanya Seva Sangh, Parle, Mumbai
16. Orissa Consumers' Association, Cuttack
17. Rajkot Sahar/Jilla Grahak Suraksha Mandal, Rajkot
18. Society for Consumers' and Investors' Protection, New Delhi
19. Tamilnadu Investors Association, Chennai
20. The Bombay Shareholders' Association, Mumbai
21. The Gujarat Investors and Shareholders Association, Ahmedabad

SEBI provided financial assistance and educational material to these associations in order to empower them to act as conduits of its investor education and grievance redressal efforts. SEBI also helped the Investors Associations by giving them grants for procuring computers, office equipments and other infrastructural items.

a) Decisions following deliberations in the meeting of Investors' Associations with SEBI Officials

SEBI conducted periodical meetings with representatives of recognised Investors' Associations which give an opportunity to

consider representations/submissions on matters of policy made by the Investors' Associations.

Two recent directions were issued taking into consideration the views expressed by these Associations at these meetings:

- Removal of earlier instruction mandating issuance of a new DIS booklet to an investor only after the number of DIS in the earlier booklet had reduced to 5 (25 per cent of the total 20); and
- Taking note of the fact that the SEBI (DIP) guidelines only require the quotation of the PAN number in issue application forms and not a photocopy of the PAN card as being asked for, SEBI instructed merchant bankers to ensure that no application was rejected for want of a copy of the PAN card.

b) Committee on Transmission of Shares

During an Investors' association meeting, it was pointed out by some representatives of the Investors Associations that despite the legislative intent to simplify the procedure of transmission of shares, companies had over a period of time evolved varying and diverse documentary compliances on the part of the legal representative of the deceased security holder which make transmission of shares, a long and tedious process. To address this issue and to evolve a uniform procedure and to alleviate and redress complaints received by SEBI in relation to 'Transmission of Shares', a Group headed by Shri R. K. Nair, Executive Director, SEBI was set up.

The Group took feedback of representatives from RAIN, public sector and private sector banks, NSDL, CDSL, investors' associations recognised by SEBI and ICSI member of Technical Committee on Transmission to arrive at an overall picture of the difficulties faced by all the concerned parties in a case of transmission of shares.

The Group had submitted its recommendations for simplifying the procedure in relation to 'Transmission of Shares' in the physical and dematerialised environment which are under examination.

v. SEBI Investor Protection and Education Fund

Para 91 of the Union Budget speech 2006-07, reads "An investor protection fund to be set up under the aegis of SEBI funded by fines and penalties recovered by SEBI".

SEBI had been working in co-ordination with the Ministry of Finance to achieve this objective. As a part of this proposal and based on the Kania committee recommendations, SEBI had suggested to the Finance Ministry other sources of income for the proposed fund as:

a) Unclaimed amount of dividend or interest lying with a mutual fund, collective investment company or venture capital fund.

b) Amounts or securities of clients lying unclaimed with an intermediary in the securities market.

c) Monies lying un-utilised in the Investor Protection Fund of the stock exchanges.

While the necessary action by way of amendment to the SEBI Act, 1992 was awaited, the SEBI Investor Protection and Education Fund (IPEF) was created by SEBI from its own corpus by an executive order dated July 23, 2007 passed under Section 11 of the SEBI Act and an amount of Rs.10 crore had been credited to it. The operational guidelines of the fund were detailed in the draft SEBI IPEF Regulations, 2008, which were posted on the SEBI website for public comments.

VIII. Retrospect and Prospects

i. Retrospect

So far, Indian economy has continued to sustain a high rate of growth during the Tenth Plan period. During 2007-08, the GDP growth rate was 9.0 per cent. The continued momentum in manufacturing and service sector albeit at a decreasing rate resulted in higher capacity utilisation and increased business confidence.

The investors' confidence was also reflected in the activities in the securities market. The securities market continued to gather momentum with the BSE Sensex crossing the 14,000 mark for the first time on April 24, 2007. Thereafter, it crossed 20,000 level on December 11, 2007. It touched an all time high of 20873.33 on January 08, 2008. During 2007-08, BSE Sensex gained 19.5 per cent and Nifty gained 23.9 per cent over March 2007. Reflecting the price appreciation, market capitalisation (of BSE) to GDP ratio and the traded value (of BSE and NSE together) to GDP ratio increased to 109 per cent and 108.8 per cent, respectively in 2007-08 from 85.5 per cent and 70.0 per cent a year ago. The rally in securities market was broad-based with all the sectors registering gains. Besides FIIs, mutual funds and retail investors were also active in the secondary market. Backed by strong macro-economic fundamentals, the overall market sentiment was buoyant throughout the major part of the year, except in last quarter of 2008. The market witnessed a major correction in January 31, 2008, leading to a fall of Sensex by 13.0 per cent and Nifty by 16.3 per cent over December 31, 2007 on account of global stock price meltdown.

The primary market witnessed continued high activity during 2007-08. Though the same number of companies (124) accessed the primary market in 2007-08, the amount mobilised was Rs. 87,029 crore during 2007-08, higher than Rs. 33,508 crore mobilised during 2006-07. The number of Initial Public Offerings (IPOs) increased to 85 in 2007-08 from 77 in 2006-07, however, the number of rights issue in 2007-08 declined to 32 from 39 in 2006-07.

There was an increase in the mobilisation of resources by the mutual funds in 2007-08. With private sector mutual funds dominating the resource mobilisation efforts, the net resources mobilised by all mutual funds were higher at Rs. 1,53,802 crore during 2007-08 compared to Rs. 93,985 crore in 2006-07. The exposure of mutual funds to the debt segment increased, commensurate with higher mobilisation of resources under various debt schemes.

The FIIs continued to invest in Indian market. The number of SEBI registered FIIs went up to 1319 by end March 2008 from 997 a year ago. Their net investment in equities was USD 12,913 million in 2007-08 as against USD 5,475 million a year earlier.

ii. Prospects

Keeping in line with the Budget proposals and also to pursue the ongoing reform initiatives, the major items on SEBI's agenda during 2008-09 would be as follows:

- Providing guidelines and formulating regulations to facilitate the launch of exchange traded currency and interest rate futures market;
- Framing regulations for the market for tradable domestic convertible bonds to enable investors to separate the embedded equity option from the convertible bond and trade it separately;
- Developing a market based system for classifying financial instruments based on their complexity and inherent risks;
- To provide education to all in the areas relating to securities market through the help of institute of Securities Market.

- To conduct investor survey in the country to find out the number of investors, their preference for investments in different instruments, like equities, bonds, mutual funds, etc., and to know the reasons for not investing in securities market;
- To review public issue guidelines to further streamline the process to reduce the time gap between opening of issue and allotment of shares; and
- Providing guidelines and formulating Regulations to facilitate the launch of small and medium enterprises (SMEs) exchanges.