ANNUAL REPORT 2005-06

Summary

SECURITIES AND EXCHANGE BOARD OF INDIA

SEBI ANNUAL REPORT 2005-06: SUMMARY

The SEBI Annual Report 2005-06 was approved by the SEBI Board at the meeting held on June 26, 2006 and was submitted to the Ministry of Finance (MoF), Government of India on June 30, 2006. The printed version of the Report has been placed before both houses of the Parliament during the Monsoon Session.

The SEBI Annual Report 2005-06 articulates the manner in which SEBI discharged its responsibilities and exercised its powers during the year under review. The overall format of the Annual Report remained same as in the previous year. The Annual Report 2005-06 has Five Parts. Part One of the report presents the policies and programmes pursued by SEBI during 2005-06. Part Two reviews trends and operations of the Indian securities market. Part Three provides a detailed account of regulation of the securities market. Part Four presents the regulatory changes including significant court pronouncements. Part Five presents organisational matters. The part-wise summary of the SEBI Annual Report 2005-06 is furnished below.

Part One: Policies and Programmes

The policy initiatives undertaken during 2005-06 were as follows:

- SEBI Disclosure and Investor Protection (DIP) Guidelines, 2000 relating to book-building issues were amended to introduce a specific allocation of 5 per cent for Mutual Funds, proportionate allotment to Qualified Institutional Buyers (QIBs) and margin requirement for QIBs.
- In order to ensure faster and hassle-free refunds, it was decided to extend the facility of electronic clearing services to refunds arising out of public issues, initially at 15 centers where clearing houses are managed by the Reserve Bank of India (RBI).

- In order to ensure availability of floating stocks on a continuous basis and maintain uniformity for the purpose of continuous listing, it was decided to amend SEBI (DIP) Guidelines, 2000 prescribing minimum public shareholding of 25 per cent in case of all listed companies barring a few exceptions.
- In order to assist the investors, particularly the retail investors, in-principle approval was given for grading of IPOs by the rating agencies at the option of the issuers. SEBI will not certify the assessment made by the rating agencies.
- In order to rationalise the disclosure requirements, it was decided to do away with voluminous and repetitive disclosures in case of rights issues and public issues by the listed companies which have a satisfactory track record of filing periodic returns with the stock exchanges and have a comprehensive mechanism for satisfactory redressal of investor grievances.
- It was decided to permit an issuer company making a rights issue to despatch an abridged letter of offer which shall contain disclosures as required to be given in the case of an abridged prospectus.
- It was decided to permit a listed company to fix and disclose the issue price in case of a rights issue, any time prior to fixing of the record date in consultation with the designated stock exchange, and in case of public issue through fixed price route, at any time prior to filing of the prospectus with the Registrar of Companies.
- In order to facilitate additional resource mobilisation, a company is permitted to issue further shares after filing a draft offer document with SEBI, provided full disclosures as regards the total capital to be raised from such further issues are made in the draft offer document.
- Listed companies were advised to comply with the provision of revised Clause 49 of the Listing Agreement on corporate governance, including appointment of the independent directors by December 31, 2005.

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

- SEBI advised the depositories/DPs not to levy any charges when a Beneficiary Owner (BO) transfers all securities lying in his/her account to another branch of the same Depository Participant (DP) or to another DP of the same depository or another depository, provided the BO accounts at the transferee DP and at transferor DP are one and the same.

- In order to prevent off-market trades prior to the commencement of trading, SEBI advised depositories that, in case of IPOs, the ISINs of securities should be activated only on the date of commencement of trading on the stock exchanges.

- Following recommendations of the Jagdish Capoor Committee, it was decided to resume in phases registration under the MAPIN Regulations to obtain the Unique Identification Number (UIN) with biometric impression for a trade order value of Rs.5 lakh and above.

- In order to streamline the settlement system consistent with IOSCO CPSS Task Force recommendations, transactions executed on the stock exchanges would be necessarily settled through the clearing corporation/clearing house of the stock exchanges.

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

- ❖ On the basis of information provided by depositories regarding establishment of connectivity with both depositories, stock exchanges were advised to shift the shares of certain companies from Trade-for-Trade segment to Rolling Settlement subject to their having at least 50 per cent of non-promoter holdings in demat mode as per Clause 35 of the Listing Agreement.

- ❖ A Committee was set up under the Chairmanship of Shri G. Anantharaman, Whole Time Member, SEBI to "Review and Examine the Future of the Regional Stock Exchanges (RSEs): Post-Demutualisation". According to the terms of reference, the Committee has to deliberate and advise on the future role of RSEs, the manner of dealing with assets in the event of withdrawal of recognition and the process of divestment of their shareholding.

- ❖ Based on recommendations of the Secondary Market Advisory Committee, the trading member position limit for stock-based derivatives has been revised.

- ❖ SEBI allowed mutual funds to participate in the derivatives market in the same manner as the FIIs, subject to position limits.

- ❖ The eligibility criteria for introduction of derivatives on stocks of companies undergoing restructuring have been prescribed whereby, it has been specified that derivatives can be introduced on stocks of large companies undergoing corporate restructuring on the first day of listing subject to certain conditions.

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

- ❖ Based on recommendations of the Madhukar Committee, the SEBI (Mutual Funds) Regulations, 1996 were amended and a notification was issued on January 12, 2006 permitting mutual funds to introduce Gold Exchange Traded Funds (GETFs) in India subject to certain investment restrictions.

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

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

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

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

- ❖ The cumulative debt investment limit for FII investment in debt securities for 2006-07 has been revised upward by the Government within the overall limit of External Commercial Borrowings (ECBs). While such limit for Government securities

(G-sec), including Treasury Bills, was raised from US $ 1.75 billion to US $ 2.0 billion, the same for the corporate debt was increased from US $ 0.5 billion to US $ 1.5 billion.

- In order to provide flexibility to corporate restructuring, SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 is being amended to provide for removal of restrictions on market purchases and preferential allotments. The outgoing shareholders can sell entire stake to the incoming acquirer in case of takeover. However, if the target company's minimum public shareholding falls below the prescribed minimum, the restoration should take place through a framework provided by the revised Clause 40A of the Listing Agreement.
- In order to simplify the existing framework, the SEBI (Delisting of Securities) Guidelines, 2003 were amended making it possible for stock exchanges to delist the shares of companies non-compliant with the Listing Agreement.

Part Two: Review of Trends and Operations

- The revival of the primary market, which started in 2003-04, gathered momentum in 2004-05, and was further invigorated in 2005-06.
- Strong macro-economic fundamentals, sustained growth of the manufacturing sector, active institutional support lent by FIIs and mutual funds, positive investment climate, sound business outlook, encouraging corporate results and buoyant secondary market induced large number of companies to raise resources from the primary market.
- During 2005-06, 139 companies accessed the primary market through public and rights issues and mobilised Rs.27,382 crore compared to 60 companies raising Rs.28,256 crore in 2004-05.

- Excluding offer for sale, the amount raised during 2005-06 stood at Rs.27,104 crore, which was higher than that of Rs.25,056 crore mobilised in the previous year.

- All the public issues through IPOs in 2005-06 emanated from the private sector companies, except one *i.e.,* Gujarat State Petronet Ltd., which was a public sector non-financial company.

- The sector-wise classification reveals that private sector garnered Rs.20,199 crore through 131 issues in 2005-06 whereas public sector mobilised Rs.7,183 crore through 8 issues.

- Industry-wise, banks/ financial institutions continued to dominate and mobilised Rs.12,439 crore (45.4 per cent) in 2005-06 through 12 issues.

- The Indian stock market witnessed unprecedented buoyancy during 2005-06 and thereby surpassed many of its previous records.

- The BSE Sensex and S&P CNX Nifty appreciated by 73.7 per cent and 67.1 per cent, respectively over March 31, 2005. The BSE Sensex gained by 4787 points during the financial year to close at an all time high of 11280 on March 31, 2006. The S&P CNX Nifty also added 1367 points to close at a high of 3403 on March 31, 2006.

- Commensurate with rise in the stock prices, the turnover and market capitalisation in the cash segment increased significantly in 2005-06. Turnover in cash segment was Rs.23,90,103 crore, a rise of 43.4 per cent over the previous year. BSE market capitalisation rose by 77.9 per cent to Rs.30,22,190 crore over the previous year.

- The market capitalisation to GDP ratio increased significantly during 2005-06 and reached an all-time high of about 85.6 per cent. There was also a significant rise in the traded value to GDP ratio which rose from 53.4 per cent in 2004-05 to 67.7 per cent in 2005-06.

- ❖ The rise in the traded value to GDP ratio of the derivatives segment, which jumped from 82.1 per cent in 2004-05 to 136.6 per cent in 2005-06, was more impressive.
- ❖ Among the sectoral indices, the highest gain was recorded by BSE Capital Goods index (156.0 per cent), followed by BSE Consumer Durables index (115.4 per cent), BSE FMCG index (110.1 per cent) and BSE Auto index (101.2 per cent).
- ❖ The valuation of the shares could be gauged from the price-earnings (P/E) ratio. In contrast to the trend in the previous year, the P/E ratios of major indices scaled upward in 2005-06.
- ❖ The annualised volatility of BSE Sensex, measured by standard deviation of log returns, declined to 16.3 per cent in 2005-06 from 23.8 per cent in the previous year. A similar trend was also observed for S&P CNX Nifty.
- ❖ About 86 per cent of the shares were traded for more than 100 days at BSE in 2005-06 compared to 81 per cent in 2004-05. However, the percentage share of this group of shares declined modestly from 96 per cent to 92 per cent in NSE during the same period.
- ❖ The number of companies signed up for dematerialisation at NSDL rose from 5,537 in 2004-05 to 6,022 in 2005-06. In CDSL, the number of companies signed up also increased from 5,068 in 2004-05 to 5,479 in 2005-06.
- ❖ During 2005-06, the turnover of derivatives market was 307.4 per cent of the cash market turnover at NSE and 202.2 per cent of the combined cash market turnover of BSE and NSE.

- The total number of contracts traded in the derivatives segment of NSE more than doubled to 15,76,19,271 in 2005-06 from 7,70,17,185 in 2004-05.

- The average daily turnover rose by 89.7 per cent to Rs.19,220 crore in 2005-06 compared to Rs.10,131 crore in 2004-05.

- Open interest increased by 82.7 per cent to Rs.38,469 crore at the end of March 2006 compared to Rs.21,052 crore a year ago.

- The gross mobilisation of resources by all mutual funds during 2005-06 stood at Rs.10,98,149 crore compared to Rs.8,39,708 crore during the previous year – an increase of 30.8 per cent over the year.

- The net mobilisation of resources by all mutual funds at Rs.52,779 crore in 2005-06 was the highest ever in a single year compared to Rs.2,200 crore in 2004-05 and Rs.46,808 crore in 2003-04.

- There were 592 mutual fund schemes as on March 31, 2006, of which, 325 were income/debt oriented schemes, 231 were growth/equity oriented schemes and the remaining 36 were balanced schemes.

- The total assets under management by all mutual funds rose substantially by 55.0 per cent to Rs.2,31,862 crore at the end of March 31, 2006 from Rs.1,49,600 crore a year ago.

- The gross purchases of both debt and equity by FIIs increased by 59.9 per cent to Rs.3,46,978 crore in 2005-06 from Rs.2,16,953 crore in 2004-05. However, the net investment by FIIs in 2005-06 declined by 9.6 per cent to Rs.41,467 crore in 2005-06 from Rs.45,881 crore in 2004-05 mainly due to large net outflows from the debt segment.

- The net investment by FIIs in equity was Rs.48,801 crore in 2005-06, the highest ever in a single year.

- Several factors are responsible for increasing confidence of FIIs on the Indian stock market which, *inter alia*, include strong macro-economic fundamentals of the economy, transparent regulatory system, abolition of long-term capital gains tax and encouraging corporate results.

- India has a developed Government securities (G-sec) market. G-sec yields increased across the entire maturity spectrum in 2005-06 due to pressure arising out of high level of sovereign borrowing and pick up in the non-food credit.

- Although the public issue of bonds were conspicuous by their absence in 2005-06, corporate sector mobilised large amount of resources (Rs.83,827 crore) by way of private placements.

Part Three: Regulation of Securities Market

This part of the Report delineates the functions of SEBI as specified in Section 11 of the SEBI Act, 1992.

- Number of brokers registered with SEBI as on March 31, 2006 was 9,335 as against 9,128 a year ago, a rise of 207 over the year.

- Among the exchanges, National Stock Exchange (NSE) had the highest number of brokers at 1,014, followed by the Calcutta Stock Exchange (962) and BSE (840) as on March 31, 2006.

- As on March 31, 2006, the number of sub-brokers registered was 23,479 as against 13,684 a year ago, indicating a net addition of 9,795 during 2005-06.

- During 2005-06, SEBI granted tenure period renewal to one stock exchange and yearly renewal to 10 stock exchanges.

- During 2005-06, 224 new FIIs were registered with SEBI and a few were de-registered. As a result, the number of FIIs registered with SEBI as on March 31, 2006 stood at 882 compared to 685 as on March 31, 2005.
- As on March 31, 2006, there were 38 mutual funds registered with SEBI of which 30 belonged to the private sector and 8 (including the UTI) were in the public sector.
- The number of indigenous venture capital funds increased substantially to 80 during 2005-06 from 50 in 2004-05, an increase of 30 over the previous year. There was also an addition of 25 foreign venture capital funds during 2005-06.
- During 2005-06, the amount of fees and other charges received was Rs.57.6 crore as against Rs.169.9 crore in 2004-05, a decline of Rs.112.3 crore or 66.1 per cent over the year. During 2004-05, collection of fees was high due to one-time receipt of arrears from the brokers and sub-brokers.
- In order to further enhance efficacy of the surveillance function, SEBI decided to put in place a world-class comprehensive Integrated Market Surveillance System (IMSS) across stock exchanges and across market segments (cash and derivatives markets).
- The Integrated Surveillance Department of SEBI monitored market movements, analysed trading pattern in scrips and indices and initiated appropriate actions in co-ordination with stock exchanges and depositories.
- SEBI-RBI Group on integrated system of alerts has been set up to share information and to recommend suitable measures so that co-ordinated actions are taken.
- During 2005-06, 165 new cases were taken up for investigation and 81 cases were completed.

- During 2005-06, 411 orders were passed/reports submitted, of which 221 pertained to enquiries and 190 related to adjudications. During the same period, hearings for 196 cases were conducted, of which 88 pertained to enquires and 108 to adjudications. During 2005-06, 247 show cause notices were issued to different entities, of which 214 pertained to adjudication cases and 33 related to enquires.
- In keeping with the strategy of focused investigation, the number of prosecution cases launched was 26 in 2005-06 compared to 84 cases in 2004-05. As a consequence, the number of persons/ entities against whom such cases were launched was also lower at 81 in 2005-06 compared to 410 in the previous year.

Part Four: Regulatory Changes

In order to fine tune the regulatory framework, the following amendments were made during 2005-06:

- SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) (Amendment) Regulations, 2005.
- SEBI (Mutual Funds) (Amendment) Regulations, 2006.
- SEBI (Custodian of Securities) (Amendment) Regulations, 2006.
- SEBI (Venture Capital Funds) (Amendment) Regulations, 2006.

Part Five: Organisational Matters

This part provides details about the SEBI Board, human resources, promotion of official language, progress of information technology, physical infrastructure, international co-operation, Parliamentary Committee, and implementation of Right to Information Act.