Policy developments

Liberalisation of FII flows

4.43 One of the cumbersome features of India's policy framework governing foreign portfolio investment has been the application of sectoral FDI limits upon FII investments. The 2002-03 budget speech had suggested that FII investments would not be subject to these limits. A committee, chaired by the Chief Economic Advisor, was constituted to analyse these questions, with representation from Department of Economic Affairs and Department of Industrial Policy and Promotion. The recommendations of the committee, submitted in June 2004, were as follows:

- Recommendations were made about simplication of registration and renewal of FII status.
- The 24 per cent limit on FII investment imposed in 1992, when FII inflows first began, was exclusive of the FDI limit. Hence, in general, FII investment ceilings, if any, should be reckoned over and above FDI sectoral caps.
- The special procedure for raising FII investments beyond 24 per cent upto the FDI limit in a company should be dispensed with, by amending the relevant SEBI FII regulations.
- In order to provide dispersed investments and prevent concentrated ownership, the present cap of 10 per cent by an FII in a single company should be retained.
- Apart from the above, which apply to all sectors, specific proposals are made pertaining to four sectors. In telecom, the composite cap on FDI and FII investment may be enhanced to 74 per cent without separate sub-ceilings. In defence, a composite cap of 49 per cent may be imposed with no sub-ceiling for FDI and FII. In PSU banks where a composite cap of 20 per cent for foreign investment applies, FII investment up to 20 per cent over and above the existing cap of 20 per cent should be allowed, while amending statutes to prevent board representation by FIIs. In insurance companies, as in defence production, the composite cap may be enhanced to 49 per cent by amending the relevant statutes.
- The prohibition on FII investment in print media and gambling may continue.

4.44 Most of the recommendations of the committee are presently under consideration. Another policy analysis effort is underway, in the form of a Committee, also headed by the Chief Economic Advisor, to evaluate mechanisms to encourage FII flows while curbing speculative tendencies.

SMILE report

4.45 In April 2004, SEBI setup the Securities Market Infrastructure Leveraging Expert (SMILE) committee, chaired by Dr. P. J. Nayak. In its report on primary market infrastructure, the committee noted the fact that primary market issuance still takes 15 days, from the date of closure of the issue, for securities to be allotted to investors. This is in sharp contrast with the secondary market, where the settlement cycle has been shortened to T+2.

4.46 The committee found that it was possible to eliminate repeated data entry of demographic details (name, address, etc.) of investors by using data available with depositories. The committee also found that reconciliation of payment details with application forms was a bottleneck and suggested ways to cut down delays on this account. The committee has further suggested that lead managers should be charged with the responsibility of appointing appropriate registrars and bankers to ensure that the primary issuance process is completed on T+6 basis. The existing practice of issuers appointing various agents has resulted in lack of coordination among different entities. The committee suggested that bunching of applications on the last days should be addressed by providing differential weightage to applications received earlier. To enhance investor convenience, especially for NRIs, the committee suggested receipt of electronic forms with electronic remittances and use of digital signatures. Considering that automation in various intermediaries is getting intensified, the committee suggested that SEBI may mandate minimal infrastructure and system audit requirements.

4.47 In its report on the mutual fund industry, the committee has noted that the reach of the mutual fund industry is considerably smaller than the reach of brokers and depository participants in the secondary market. The committee has recommended to SEBI that apart from the existing model, SEBI should consider encouraging mutual funds to go through either the depositories model or a distributor model. The depositories model has the obvious advantage of giving investors a single consolidated statement for all investments, which is analogous with the proposal about the New Pension System. The committee has, however, recommended that the regulator should take a neutral stance towards alternate models and let the market decide the outcome. The committee has further suggested that SEBI should review the current procedure of giving the NAV to investors before the funds are actually received by the mutual fund. It has advocated allocation of units and NAV on the basis of clear funds being available to the mutual fund.

The MAPIN database

4.48 SEBI is developing a database about market participants and investors, called the MAPIN database, to give a Unique Identification Number (UIN) to individuals and entities participating in the capital market. Once the database is built, SEBI will mandate that transactions of concerned participants (primary market, secondary market, etc.) are identified with the UIN.

4.49 The MAPIN databases utilises fingerprints as an identifier, apart from traditional identifiers such as photographs, name and address. Fingerprints are photographs of fingers, and are a good tool in the effort of establishing uniqueness, and preventing the opening of *benami* accounts. Present day technology makes it possible to collect such data in an affordable and convenient manner. The use of fingerprints is not unique to MAPIN; fingerprints are currently used in the registration of sale of real estate also.

4.50 This unique identity will be critical to the ability of SEBI to rapidly investigate market misbehaviour. The stock exchanges (for secondary market trades) and registrars (for primary market applications) have digitised information. Such information can be analysed very easily if each transaction is linked to the UIN.