

Review of policy developments

Development of markets for corporate bonds and securitised debt

4.27 Several initiatives were announced by the Government in the Budget 2005-06 to develop the debt markets and let it catch up with the equity market which is highly developed by international standards. Pursuant to the Budget announcement of 2005-06, Government of India, Ministry of Finance appointed a High Level Expert Committee on Corporate Bonds and Securitisation to look in to the legal, regulatory, tax and market design issues in the development of corporate bond market. The Committee has given important recommendations in the area of market development through regulatory changes, institutional development and tax related changes.

4.28 Further, the Securities Contracts (Regulation) Amendment Bill, 2005 was introduced in the Lok Sabha on December 16, 2005 pursuant to the announcement in Budget 2005-06 for provision of a legal framework for trading of securitised debt including mortgage-backed debt. The Bill stands referred to the Standing Committee on Finance. The proposal is to amend the definition of "Securities" under the Securities Contracts (Regulation) Act, 1956 so that all transactions in securities debt, whether based on Asset Backed Securities (ABS) or Residential Mortgage-Backed Securities (RMBS), are covered under that definition, and the entire institutional and regulatory framework for trading of "securities" is applicable for "securitised debt" also. This amendment will facilitate the development of a vibrant and active secondary market for trading securitized debt instruments including mortgage-backed debt instruments on stock exchanges.

The IPO mechanism

4.29 The IPO market has made enormous progress in recent years, moving away from fixed-price offerings to price discovery through a screen-based auction. This has reflected a quest to discover the price through an open, fair, competitive auction, which is done in a

fully transparent way, where all investors participate in an equal setting, and the investment bankers' or other influences do not vitiate the allocation of shares. These attributes are similar to the secondary market, where all kinds of investors participate in a unified, competitive process of price discovery unengineered by interested parties.

4.30 Till recently, mutual funds registered with Securities and Exchange Board of India (SEBI) in terms of SEBI (Mutual Funds) Regulation were not given any separate allocation within the Qualified Institutional Buyer (QIB) category in case of book-built issues. The guidelines were amended in September 2005 to provide for a specific quota of 5 per cent to the mutual funds within the category of QIBs. This will help ensure minimal sale of shares to mutual funds in IPO auctions.

4.31 Recent events have revealed individual investors placing multiple bids in the IPO auctions, in order to benefit from the quota that has been made available to individual investors. While the full investigation is still underway, this experience emphasises the need to shift away from a system of quotas to a non-discretionary price discovery through a unified auction, in a framework which is close to the price discovery of the secondary market.

4.32 Till recently, the allotment to QIBs was decided by the Issuer Company in consultation with the Book Running Lead Managers (BRLMs). In an attempt to shift towards non-discretionary, competitive price discovery through a pure auction process, the discretionary allotment system for QIBs has been withdrawn.

4.33 The SEBI Board has granted 'in principle' approval for introduction of optional "grading" of public issues by unlisted companies (viz. IPOs) by credit rating agencies registered with SEBI. The rating is intended to be an independent and unbiased opinion of the credit rating agency about the likelihood of positive returns for the investor between purchase at the IPO and sale on the secondary market. If the issuer pays for the

rating, this introduces conflicts of interest. Hence, the cost of IPO grading is sought to be passed on to stock exchanges and the Investor Education and Protection Fund (IEPF).

Rationalisation of Disclosure Requirements for Seasoned Equity Offerings (SEOs)

4.34 The present disclosure framework for primary market issuance is the same for unlisted companies doing an IPO or listed companies doing an SEO. However, once a company is listed, a substantial burden of disclosure and particularly continuous disclosure applies, with considerable information required to be placed in the public domain on an ongoing basis. Hence, the disclosure requirements for an SEO have been considerably eased, thus reducing the cost of issuance.

Common platform for Electronic Filing and Dissemination of Corporate Information (EDIFAR)

4.35 In terms of the listing agreement, listed companies are required to disclose corporate information to the stock exchanges where they are listed and also on the EDIFAR, an electronic filing platform currently maintained by SEBI. This results in multiple disclosures/filings for the companies that are listed on more than one exchange. SEBI, in consultation with NSE and BSE, is in the process of bringing a common electronic platform maintained/run by Stock Exchanges. A listed company would be required to file only on this platform for the purpose of satisfying the requirements of listing agreement. The proposed platform would introduce single window filing and would also serve as a one stop shop for dissemination of corporate information of listed companies to investors.

Resumption of MAPIN

4.36 It has been decided to resume fresh registrations for obtaining Unique Identification Number (UIN) under SEBI (Central Database of Market Participants) Regulations, 2003 (MAPIN), in a phased manner. To begin with, the cut off limit for obtaining UIN with biometric

impressions for natural persons has been raised from the existing limit of trade order value of Rs.1.00 lakh to Rs.5.00 lakh or more. The limit will be reduced progressively. Agencies capable of providing such facilities in a cost-effective manner will be assigned the responsibility of maintaining the databases. For trade order value of less than Rs.5.00 lakh, an option will be available to investors to obtain either the Permanent Account Number issued by the Income Tax Department or UIN obtained under MAPIN. Investors in mutual funds would be exempted from the requirement of obtaining UIN. The definition of promoter, which is a body corporate, would be limited to immediate holding company of the Indian entity and any of the subsidiaries, if located in India. Promoters, directors, officers and designated employees of listed companies would be required to obtain the UIN.

Broker-client relationship when sub-broker is present

4.37 SEBI (Stock Brokers and Sub-brokers) (Amendment) Regulations, 2003 was notified on September 23, 2003. In 2005, significant regulatory changes were brought about in SEBI (Stock Brokers and Sub-brokers) (Amendment) Regulations. The above amendments were brought in as an investor protection measure so that the investors are aware of the entity that is responsible for servicing them and to establish firmly the role of stock brokers vis-à-vis ultimate clients of the sub-broker. It also makes the brokers explicitly responsible towards such clients and insulates the client from the defaults of the sub-broker and the consequences of their acts of omission and commission.

Decoupling of spot market for institutional investors

4.38 Until recently, a core principle of the Indian equity market had been that all orders – large or small – are matched on a single platform in a unified price discovery. Institutional investors are able to discuss a large transaction on telephone, but the orders had to be exposed to the order book on the screen, thus disciplining the price at which institutional transactions take place. This has

given full transparency, unified price discovery, and opportunities for retail investors who have orders on the screen to participate in the prices at which an institutional transaction is taking place.

4.39 However, this mechanism was found to be cumbersome for institutional investors, who seek to match orders at prices without constraints from the underlying order book of the country. Stock exchanges have now been advised by SEBI to put in place a separate trading window for the execution of large transactions (minimum quantity of 5,00,000 shares or minimum value of Rs.5 crore) subject to certain conditions. Furthermore, in an attempt at improving the information flow about such transactions to the broad market, SEBI has specified that stock exchanges shall disseminate information on such block deals, viz., the name of the scrip, name of the client, quantity of shares bought/sold, traded price, etc., to the general public on the transaction date, after market hours. Though the dissemination of the information after market hours has limited utility, none-the-less it induces greater transparency in some ways – since institutional transactions are now not anonymous. This separate window for execution of block deals has been operationalised in BSE and NSE with effect from November 14, 2005.

Amendment to Takeover Regulations

4.40 SEBI Board in its meeting held on December 30, 2005 approved important amendments to SEBI Takeover Regulations. The amendments provide flexibility to corporate restructuring. At the same time, to ensure the maintenance of minimum public shareholding for continuous listing, it has been decided that if in the process of corporate restructuring under Takeover Regulations, the target company's public shareholding falls below the prescribed minimum, the restoration of minimum public shareholding will take place through the framework provided in the revised Clause 40A of Listing Agreement.

4.41 Among other things, restrictions on market purchases and preferential allotments as in the Takeover Regulations have been

removed. It has also been provided that the outgoing shareholder (promoter) can sell the entire stake to the incoming acquirer in case of takeover. Further, shareholders holding more than 55 per cent of equity would be able to make further acquisitions subject to making an open offer.

Revision of Trading Member Position Limits for Stock Based Derivatives

4.42 Owing to higher stock prices, position limits expressed in rupees had effectively dropped considerably. The trading member position limits for stock-based derivatives has been revised on the basis of the recommendations of the Secondary Market Advisory Committee. The new limits are as follows

- i) For stocks having applicable market-wide position limit of Rs. 500 crore or more, the combined futures and options position limit is 20 per cent of applicable market-wide position limit or Rs. 300 crore, whichever is lower and within which stock futures position cannot exceed 10 per cent of applicable market-wide position limit or Rs. 150 crore, whichever is lower.
- ii) For stocks having applicable market-wide position limit less than Rs. 500 crore, the combined futures and options position limit is 20 per cent of applicable market-wide position limit, and futures position cannot exceed 20 per cent of applicable market-wide position limit or Rs. 50 crore whichever is lower.
- iii) The market-wide position limit and client level position limits, however, remain the same as prescribed.

4.43 The enhanced limits will enable participants to hedge their positions more effectively, especially for stocks with large market capitalisation and higher liquidity. Separate position limits have been built in for stock options to provide an impetus for the options market.

Level Playing Field between Domestic Mutual Funds vis-à-vis Foreign Institutional Investors

4.44 There was a need to treat all institutional investors participating in the derivatives markets on an equal footing. It was felt that by not hedging or diversifying the portfolio risks in the derivatives market, mutual funds were not using the full market potential for the benefit of small investors. In order to encourage mutual funds' participation in the derivatives market and to bring about a level playing field vis-à-vis FIIs, SEBI has permitted mutual funds to enter into all types of derivative transactions with adequate disclosures made to the investors. However, the mutual fund positions in derivatives market would be subject to the limits specified by SEBI. The position limits that have been specified for a mutual fund are the same as that of an FII, and the position limits for a scheme of a mutual fund are the same as the limits for a sub-account of an FII.

Introduction of Gold Exchange Traded Funds

4.45 Union Finance Minister, in his Budget 2005-06 speech, had announced the introduction of Gold Exchange Traded Funds

(GETF) in India and creation of a market for such units. Consequent upon this announcement, SEBI constituted a committee to look into all aspects of facilitating the setting up of GETF in India. After considering various issues involved in the matter, the Committee recommended that the GETF may be implemented in India based on two models: (i) Mutual Fund Custodian Bank Integrated Model, and (ii) Mutual Fund Warehouse Receipt Model. Gold ETF product launches based on these models are expected in 2006.

Modernising regulatory treatment of Foreign Institutional Investors (FII)

4.46 To broad base the category of institutions eligible for FII registration, SEBI has proposed to include insurance/reinsurance companies, investment managers, investment advisors, international or multilateral organizations, foreign governmental agencies, and foreign central banks in the eligibility list. The Ministry of Finance formed an Expert Group under the Chairmanship of the Chief Economic Adviser to look into issues of encouraging FII flows and checking the vulnerability of capital markets to speculative flows. The committee has submitted the report to the Government.