4

Securities Markets

Securities markets' performance in terms of information-processing, risk management and liquidity-provision functions improved further in 2005. In December 2005, there were 2,540 companies, where stock market trading took place on at least two-thirds of the days. These companies had a market capitalisation of Rs.24.7 lakh crore or $550 billion. Household and institutional investor participation increased through growing confidence in the transparency and robustness of the market design which was put in place over the period 1993-2001. Such participation was also assisted by stock market index returns of 11 per cent in 2004 followed by 36 per cent in 2005.

Table 4.1 : Primary market

(Rs. crore)

	Calendar year			
	2002	**2003**	**2004**	**2005**
Debt	4,549	5,284	2,383	66
Equity	2,420	2,891	33,475	30,325
Of which, IPOs	1,981	1,708	12,402	9,918
Number of IPOs	6	12	26	55
Mean IPO size	330	142	477	180
Total	6, 970	8,175	35,859	30,391
Number	28	43	65	109

Source: SEBI.

Primary Market

4.2 The primary market for equity, which consists of both the 'initial public offering' (IPO) market and the 'seasoned equity offering' (SEO) markets, experienced considerable activity in 2004 and 2005 (Table 4.1). In 2005, Rs.30,325 crore of resources were raised on this market, of which Rs.9,918 crore were made up by 55 companies which were listed for the first time (IPOs). The number of IPOs per year has risen steadily from 2002 onwards. A level of 55 IPOs in the year translates to roughly 4 IPOs every month. The mean IPO size, which was elevated in 2004, returned to Rs.180 crore, which is similar to the value prevalent in 2003.

4.3 The primary issuance of debt securities, as per SEBI, fell to a low of around Rs. 66 crore in 2005, which is one facet of the far-reaching difficulties of the debt market. Unlike equity securities, debt securities issued at previous dates are redeemed by companies every year. Hence, a year with a low issuance of fresh debt securities is a year in which the stock of outstanding debt securities drops.

4.4 In addition to resource mobilisation by the issuance of debt and equity securities, one of the most important mechanisms of financing that has been used by Indian firms is retained earnings, which are also a part of equity financing.

The Secondary Market

The secondary market for equity

4.5 The trading intensity of Indian stock exchanges is impressive by world standards. Among the biggest exchanges, measured by the number of trades per calendar year, the National Stock Exchange (NSE) retained rank 3 in all the four years (Table 4.2). The Bombay Stock Exchange (BSE) climbed from rank

Table 4.2 : Biggest exchanges by number of transactions in 2005				
	Rank by number of transactions			
	2002	2003	2004	2005
NASDAQ	1	1	1	2
NYSE	2	2	2	1
NSE	3	3	3	3
Shanghai	5	4	4	6
BSE	7	5	5	5
Korea	4	7	6	4
Taiwan	6	6	7	8
Shenzhen	8	8	8	7
Deutsche Borse	9	9	9	9
London/Euronet	12	11	10	10

7 to rank 5 between 2002 and 2003, and has stayed at rank 5 ever since. The Shanghai exchange lost ground, going from rank 4 to rank 6 in the latest year.

4.6 Both Nifty (index of the top 50 stocks of the country) and the Nifty Junior (the second-tier index of the next 50 stocks) have delivered strong positive returns in the recent four-year period (Tables 4.3 and 4.4). From January 2002 to December 2005, the Nifty index went from 1,075 to 2,837, giving compound returns of 27.45 per cent per year.

Table 4.3 : Movements of the index of the top 50 stocks (Nifty)				
	2002	2003	2004	2005
January	1,075	1,042	1,810	2,058
February	1,142	1,063	1,800	2,103
March	1,130	978	1,772	2,036
April	1,085	934	1,796	1,903
May	1,029	1,007	1,484	2,088
June	1,058	1,134	1,506	2,221
July	959	1,186	1,632	2,312
August	1,011	1,357	1,632	2,385
September	963	1,417	1,746	2,601
October	951	1,556	1,787	2,371
November	1,050	1,615	1,959	2,652
December	1,094	1,880	2,081	2,837

Table 4.4 : Movements of the index of the next 50 stocks (Nifty Junior)				
	2002	2003	2004	2005
January	1,349	1,377	3,368	4,248
February	1,496	1,387	3,331	4,388
March	1,567	1,260	3,392	4,275
April	1,608	1,340	3,640	4,024
May	1,497	1,664	2,847	4,365
June	1,617	1,784	2,905	4,393
July	1,456	2,012	3,082	4,919
August	1,453	2,275	3,199	5,053
September	1,258	2,457	3,504	5,304
October	1,255	2,657	3,482	4,714
November	1,337	2,801	3,885	5,242
December	1,413	3,406	4,453	5,541

From January 2002 to December 2005, the Nifty Junior index went from 1,349 to 5,541, giving compound returns of 42.36 per cent per year.

4.7 These impressive returns were successfully replicated by passive managers who offered index funds on the two indexes, thus demonstrating the viability of index funds. A complete ‘index ecosystem’ is now vibrantly operating in India, comprising indexes, index funds, exchange traded funds (ETFs), index derivatives, and electronic index arbitrage. From 2004 onwards, Nifty has been the biggest underlying on the equity derivatives market on all days. The sophisticated inter-relationships between each of these elements constitute a key success of Indian financial infrastructure.

4.8 The impressive returns on indexes through the recent four years have been associated with fairly stable P/E ratios (Table 4.5). The bulk of the returns, hence, were obtained through growth in earnings of companies.

4.9 At the end of calendar 2005, the market capitalisation of Nifty at Rs.13.5 lakh crore and the Nifty Junior at Rs.2.2 lakh crore, added up to Rs.15.7 lakh crore or roughly two-thirds of the broad Indian equity market (2,540 companies with Rs.24.7 lakh crore of market

Table 4.5 : Equity returns, volatility, market capitalisation and Price Earnings (P/E) ratio				
	2002	2003	2004	2005
BSE Sensex:				
Returns (per cent)	**3.5**	**72.9**	**13.1**	**42.33**
End-year mkt.cap. *(Rs. crore)*	2,76,916	6,35,015	7,35,528	12,13,867
Daily Volatility	1.10	1.17	1.59	1.08
End-year P/E	14.64	18.86	17.07	18.61
Nifty :				
Returns (per cent)	**3.3**	**71.9**	**10.7**	**36.34**
End-year mkt.cap. *(Rs. crore)*	3,52,943	6,34,248	9,02,831	13,50,394
Daily Volatility	1.07	1.23	1.73	1.11
End-year P/E	14.83	20.73	15.32	17.07
Nifty Junior :				
Returns (per cent)	**8.8**	**141.0**	**30.8**	**24.43**
End-year mkt.cap. *(Rs. crore)*	35,668	1,32,409	1,65,444	2,18,575
Daily Volatility	1.34	1.37	1.94	1.22
End-year P/E	12.26	15.73	14.19	17.11

Source : BSE and NSE

value). This implies that the available index funds now cover two-thirds of the Indian equity market.

4.10 The volatility of the equity market in 2005 was at a low level. While this partly reflected the end of the uncertainty associated with the general elections of 2004, the volatility was also lower than that in the preceding two years.

4.11 Table 4.6 shows patterns of volatility over two recent two-year periods, for two Indian indexes (Nifty and Nifty Junior) and two indexes outside the country (the S&P 500 of the US and the Korean Seoul Composite Index). In the Indian case, the uncertainties associated with the general elections of 2004 resulted in elevated volatility in the January 2004 to December 2005 period when compared with the preceding two years. In contrast, equity volatility globally was reduced. In particular, the US S&P 500 was a remarkably low volatility asset in the recent two years, with a weekly volatility of just 1.41 per cent.

4.12 The best measure of liquidity is the 'impact cost' which is inherent when doing transactions on the secondary market. A liquid market is one where the cost of transactions is low. The impact cost for purchase or sale of Rs.50 lakh of the Nifty portfolio has dropped steadily and sharply through the recent four years, from a level of 0.12 per cent in 2002 to 0.08 per cent in 2005 (Table 4.7). Similarly,

Table 4.6 : Volatility of weekly returns on the equity market

Class of stocks	Period: Jan 2002 - Dec 2003	Period: Jan '04 - Dec '05
India		
Top 50 (Nifty)	2.59	2.85
Next 50 (Nifty Junior)	3.08	3.47
Outside India		
U.S. (S&P 500)	2.51	1.41
Korea (Kospi)	4.12	2.81

Table 4.7: Equity spot market liquidity

	For calendar year 2002	2003	2004	2005
Nifty:				
NSE impact cost at Rs. 5 million (per cent)	0.12	0.10	0.09	0.08
Nifty Junior:				
NSE impact cost at Rs.2.5 million (per cent)	0.41	0.32	0.31	0.16

the impact cost for doing purchase or sale of Rs.25 lakh of the Nifty Junior index has dropped steadily and sharply through the recent four years, from a level of 0.41 per cent in 2002 to 0.16 per cent in 2005.

4.13 These improvements suggest a substantial gain in liquidity on the Indian equity market in recent years. In addition, the gap between the liquidity of Nifty and that of Nifty junior, as shown in this data, has dropped sharply. This shows the percolation of liquidity beyond the top 50 stocks. These improvements demonstrate the success of the reforms programme on the equity market which has been undertaken from 1993 onwards. In absolute terms, these values are impressive by world standards. As an example, the impact cost of 8 basis points that is faced in doing arbitrage with the Nifty futures with a basket of roughly US$100,000 is a level that is comparable with that found in many OECD countries. This implies that index arbitrage in India can deliver levels of market efficiency on the index futures market that is comparable to that in many OECD countries.

4.14 In addition to the impact cost, market participants also have to pay user charges to the stock broker and to the exchange, and transaction taxes such as the Securities Transaction Tax. In some of these respects also, India fares well. As an example, the per-transaction charges applied by National Securities Depository Limited (NSDL) and Central Depository Services Limited (CDSL) are amongst the lowest in the world. The statistics for impact cost shown above, however, focus on the transactions costs incurred on the electronic trading system alone, and ignore these in other than electronic trading system.

4.15 While impact cost is the best measure of liquidity, since liquidity is about being able to transact at minimal cost, stock market turnover is important to market intermediaries who have revenue streams in proportion to turnover. In addition, turnover is also useful as a proxy for liquidity, in facilitating comparisons across markets where impact cost is not measured. Table 4.8 shows the growth of “net” or “one-way” turnover on the Indian equity market. From 2003 onwards, derivatives turnover has exceeded spot market turnover, as is the case with all successful derivatives markets in the world. This underlines the importance of the derivatives market, which now dominates price discovery. The number of stocks on which individual stock derivatives are traded has gone up steadily, from 31 in 2001 to 117 today, which has helped in the percolation of liquidity and market efficiency into the second tier of firms.

4.16 NSE and BSE spot market turnovers added up to Rs.20.9 lakh crore in 2005, and NSE and BSE derivatives turnover added up to Rs.39.5 lakh crore in 2005. Both these values showed significant growth when compared with the previous year. The total equity market turnover went up from Rs.43 lakh crore in 2004 to Rs.60.2 lakh crore in 2005. This growth is partly mere arithmetic, for rupee turnover goes up commensurate with higher stock prices.

4.17 In terms of the composition of market participants, the equity market continued to

Table 4.8 : Growth of turnover

(Turnover in Rs. Crore)

	For calendar year			
	2002	**2003**	**2004**	**2005**
NSE spot	6,24,322	9,07,882	11,70,298	13,88,112
BSE spot	3,32,913	409,373	5,29,704	7,01,024
NSE derivatives	3,45,443	13,50,610	25,86,738	39,26,843
BSE derivatives	928	9103	19,173	19,652
Indian equity turnover	13,03,508	27,57,287	43,14,322	60,17,944

Table 4.9 : A predominantly retail market				
	As of year-end			
	2002	2003	2004	2005
Number of NSDL accounts	38,13,336	46,12,884	59,69,000	72,76,300
Average trade size (rupees):				
NSE spot	26,703	26,993	27,716	24,293
BSE spot	22,485	22,782	25,610	13,689
NSE derivatives	3,00,334	4,25,077	4,88,790	5,01,946
Source : SEBI				

be dominated by retail investors. The average transaction size on the spot market dropped in 2005 on both NSE and BSE (Table 4.9). Across both the derivatives market and the spot market, the average transaction is one which is accessible to a very large number of households in the country. The number of depository accounts at NSDL continued to grow rapidly, with a rise of 21.9 per cent in 2005, which corresponds to over 5,000 accounts being opened per working day. In addition to NSDL, CDSL had 1,270,071 accounts as of 2005. The sum of NSDL and CDSL accounts stood at 85 lakh.

4.18 Mutual funds are an important avenue through which households participate in the securities market. Intermediation through mutual funds is particularly attractive from the viewpoint of systemic stability, because mutual funds only hold transparent assets, do daily marking to market, have no leverage, and all losses are instantly passed on to the balance sheets of households. While assets under management of all mutual funds had stagnated at roughly Rs.1.5 lakh crore between 2003 and 2004, there was a significant rise to a level of roughly Rs.2 lakh crore in 2005.

4.19 From the early 1990s, India has developed a framework through which foreign investors participate in the Indian securities markets. A foreign investor can either come into India as a foreign institutional investor (FII) or as a sub-account. In December 2005, the number of FIIs stood at 823 and the number of sub-accounts stood at 2,273.

4.20 The net investment from FIIs on the equity spot market rose from Rs.38,965 crore in 2004 to Rs.47,182 crore in 2005.

Table 4.10 : Assets under management of mutual funds *(Rs. Crore)*				
	At end of year			
	2002	2003	2004	2005
Money market	10,801	32,424	59,447	64,711
Gilt	4,316	6,917	4,876	3,730
Income	77,469	71,258	47,451	52,903
Growth	14,371	22,938	31,551	67,144
Balanced	14,164	4,663	5,472	6,833
ELSS	1,479	1,893	1,740	3,927
Total	**1,22,600**	**1,40,093**	**1,50,537**	**1,99,248**
Source : SEBI				

Table 4.11 : Foreign institutional investors				
				(*Rs. Crore*)
	For calendar year			
	2002	2003	2004	2005
End-year number of FIIs	489	517	637	823
End-year number of sub-accounts	1,372*	1,361*	1,785	2,273
Equity market activity :				
Gross buy	48,876	94,412	1,85,672	2,86,021
Gross sell	45,311	63,954	1,46,706	2,38,839
Net (Gross Buy –Gross Sell)	3,566	30,458	38,965	47,182
Derivatives activity :				
Gross buy			84,205	2,54,322
Gross sell			86,133	2,49,875
Net (Gross Buy –Gross Sell)			-1,928	4,447

* as on March, 31.
Source : SEBI.

4.21 Information about the transactions of investors – such as FIIs or institutional investors – is reported from the viewpoint of only one side of the transaction. In order to compare this against the market size, total turnover is expressed as "gross turnover" or "two-way turnover". Summing across spot and derivatives markets, the share of all institutional investors was 10.3 per cent. The share of FIIs was 8.1 per cent. These facts underline the domination of Indian retail in turnover. In particular, on the derivatives markets, which now dominate price discovery, Indian retail accounts for a substantial share of the turnover.

4.22 The growth of international trade, and India's financial market integration through the convertibility which FIIs have, is expected to lead to greater correlations between India and the global economy. This would be revealed in correlations of weekly returns of stock

Table 4.12 : Gross turnover from institutional investors				
				(*Rs. Crore*)
	For calendar year			
	2002	2003	2004	2005
Spot market:				
NSE+BSE gross turnover	19,14,273	26,34,085	34,16,824	41,78,295
All institutions	1,13,374	2,04,745	3,70,609	7,14,638
FIIs	54,016	1,58,366	3,32,379	5,02,590
Derivatives:				
NSE+BSE gross turnover	6,92,742	28,80,489	52,11,820	78,53,687
All institutions		51,397	1,76,940	5,21,762
FIIs			1,70,338	4,76,925
Equity spot + derivatives				
NSE+BSE gross turnover	26,07,015	55,14,574	86,28,645	1,20,31,981
All institutions	1,13,374	2,56,142	5,47,449	12,36,400
FIIs	54,016	1,58,366	5,02,717	9,79,515

TABLE 4.13 : Correlations of equity indexes, January 2002 to December 2003.				
	Nifty	*NiftyJunior*	*S&P 500*	*Seoul*
Nifty	1			
Nifty Junior	0.76	1		
S&P 500	0.26	0.17	1	
Seoul	0.27	0.2	0.45	1

TABLE 4.14 : Correlations of equity indexes, January 2004 to December 2005.				
	Nifty	*NiftyJunior*	*S&P 500*	*Seoul*
Nifty	1			
Nifty Junior	0.89	1		
S&P 500	0.35	0.26	1	
Seoul	0.49	0.45	0.48	1

market indexes. The correlations for two 2-year periods – 2002-2003 versus 2004-2005 – are compared in Table 4.13 and 4.14.

4.23 South Korea, which is now an OECD country and has capital account convertibility, serves as a useful comparison point for India. In the 2002-2003 period, the South Korean correlation with the US was at 0.45. This has risen slightly to 0.48 in the 2004-2005 period. In India's case, the front tier of stocks (Nifty) had a rise in the correlation with the US from 0.26 to 0.35 during the same period. Similarly, the second tier of stocks (Nifty Junior) had a rise in the correlation with the US from 0.17 to 0.26.

The secondary market for debt

4.24 The policy directions of the equity market and the debt market have taken different paths from 1992 onwards. In contrast with the blossoming institutional sophistication and growing liquidity of the equity market, the debt market has continued to turn in poor outcomes. With the continuation of substantial fiscal deficits, a large volume of bond issuance had taken place every year. However, this growing market size has not been translated into liquidity and market efficiency as yet. Impact cost, which is the best measure of liquidity of a market, is not observed on the bond market owing to non-transparent trading procedures. The turnover ratio, which is the best available proxy, dropped every year from 2002 onwards, to a level of 71 per cent in 2005. The number of bonds with a turnover ratio in excess of 75 per cent dropped from 40 bonds in 2003 to just 13 bonds in 2005.

4.25 Interest rates on the GoI bonds have risen from 2004 onwards. The zero-coupon rate on a 1-year bond rose from 4.75 per cent in 2003 to 6.09 per cent in 2004 and further to 6.28 per cent in 2005. Similarly, the zero-coupon rate on a 10-year bond rose from 5.38 per cent in 2003 to 6.78 per cent in 2004 and further to 7.22 per cent in 2005. Owing to these increases in interest rates, the returns

Table 4.15 : Government of India (GOI) bond market size

(Rs. Crore)

	For calendar year			
	2002	2003	2004	2005
Gross issuance	1,20,213	1,13,000	1,19,500	1,29,350
End-year market cap.	6,55,148	9,59,903	9,96,341	10,51,521
SGL turnover	12,93,814	15,98,052	10,70,896	7,50,982
Turnover ratio (per cent)	197.48	166.48	107.48	71.42
Number of bonds with TR > 75 per cent	33	40	28	13
Demat GOI bonds at NSDL :				
Value (Rs. crore)		1,956	3,688	5,073
Number of accounts containing GOI bonds	924	1,580	1,960	2,341

Table 4.16 : GOI bond market outcomes

	Calendar year			
	2002	2003	2004	2005
Notional GOI ZC 1-year bond:				
Interest rate	5.44	4.75	6.09	6.28
Returns (per cent)	1.37	0.73	-1.24	0.35
Returns volatility	0.15	0.27	0.36	0.29
Notional GOI ZC 10-year bond:				
Interest rate	6.12	5.38	6.78	7.22
Returns (per cent)	20.28	6.83	-12.66	-4.32
Returns volatility	0.58	0.59	0.71	0.70
NSE GOI bond index:				
Returns (per cent)	15.95	10.03	-3.75	-3.40
Returns volatility	0.43	0.39	0.59	0.66

Source : NSE

on a broad portfolio of government bonds (the GOI bond index) were negative in both 2004 and 2005. The volatility of this portfolio also rose significantly to 0.66 per cent per day in 2005.

The commodity futures markets

4.26 The last component of the Indian securities market is the commodity futures markets. These markets have been experiencing strong growth, through the introduction of nationwide electronic trading and market access, as was done on the equity market during 1994-1996. Through this, turnover rose sharply from a level of Rs.0.67 lakh crore in 2002-03 to a level of Rs.13.87 lakh crore in 2005. The National Commodity Derivatives Exchange (NCDEX) has emerged as the largest commodity futures exchange.

Table 4.17 : Turnover on commodity futures markets

(Rs. Crore)

	2002-03	2003-04	2004-05	2005-06
NCDEX	0	1,490	2,66,338	7,46,775
NBOT	34,376	53,014	58,463	37,141
MCX	0	2,456	1,65,147	5,58,364
NMCE	4,572	23,841	13,988	8,654
All exchanges*	66,530	1,29,364	5,71,759	13,87,780

*includes others.

Source: Forward Markets Commission.

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 which ever 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.

Outlook

4.47 In coming months, considerable investment appears to be in the pipeline, reflecting confidence by domestic and foreign investors in the economy. The Indian securities markets are well equipped to engage in information processing and intermediation, and support the investment activities of 2006-07. In contrast with the difficulties of forward-looking investments by bank-dominated financial systems, the Indian financial system has been effective in delivering capital to areas with high *prospective* growth, such as software or biotech, through the equity market.

4.48 How far securities markets will support investment, and hence how far investment will be stepped up in the coming months and years will also depend on the further improvements that will be made in the securities market architecture, including:

- Improving disclosure, trading technology and policies on derivatives trading so as to narrow the gap in the secondary market liquidity between the largest 100 companies and the rest.
- Increasing the size of the Indian derivatives market by reviewing the size of limits and the issue of Direct Market Access (DMA). Limits which were established in the late 1990s (at a time of cautious experimentation with the introduction of derivatives trading in India), have clearly become out of touch with the growing market size. DMA involves computerised trading systems, put into place by investors, where sophisticated software places trades based on human guidance at the level of trading strategy. DMA is particularly critical when it comes to assuring liquidity for small companies and for options trading, where trading based on labour-intensive practices is not cost efficient.
- Removing the problem of multiple bids by individuals seeking to profit from the quota for retail investors at the discretion of merchant bankers or the government by considering a pure auction for price discovery at the IPO, in much the same manner as the secondary market functions.
- Strengthening the investigation and surveillance process, so as to have a steady stream of success in enforcing rules, and punishing wrongdoers, with well-prepared and well-argued cases that are upheld by the courts.
- Improving the functioning of the bond market and bringing it at par with the architectural strengths of the equity markets.