# 4

# CAPITAL AND MONEY MARKETS

The capital markets remained subdued in 1995-96 with volatility in stock prices during the year. The bear phase which began in October 1994 continued through most of 1995-96, reflecting relatively tight domestic liquidity and a slow down in FII inflows. The BSE index reached a low of 2826 on January 25, 1996. However, there was a sharp increase in the index in February 1996 possibly on account of increased FII investments. During 1995-96 till December, the value of primary issues was marginally higher than in the corresponding period last year. This happened despite a downtrend in stock prices and low turnover in stock exchanges. FII inflows, which had fallen across the World in 1995, showed strong growth in the third quarter of 1995-96. Cut-off yields on 364 day treasury bills which had started rising around the middle of 1994-95, plateaued out around the middle of 1995-96. The yields on 91 day treasury bills eased in the second quarter of 1995-96 before firming in the third quarter.

2. The process of reforms in the capital markets including the money markets were further strengthened during 1995-96. The Securities Laws (Amendment) Act empowered SEBI to regulate all market intermediaries. An Ordinance to establish a system of depositories was promulgated addressing one of the major lacunae in the existing system. SEBI had introduced a number of new rules and regulations which will improve market practice. The National Stock Exchange expanded rapidly, providing an incentive to BSE and other exchanges to accelerate computerisation.

## Capital Market Reforms

3. Since SEBI became a statutory body in 1992, a number of steps have been taken to strengthen SEBI and reinforce its autonomy (Boxes 4.1,4.2,4.3). The SEBI Act (1992) as amended on March 25, 1995 by the Securities Laws (Amendment) Act 1995, has empowered SEBI to register and regulate new intermediaries in the capital market such as custodians, depositories, venture capital funds, credit rating agencies and foreign institutional investors. With this empowerment, all intermediaries associated with the securities market are now regulated by SEBI. Additional powers were given to SEBI to prescribe regulations related to issue of capital and transfer of securities. SEBI's independence was strengthened by allowing it to issue regulations and file suits without the prior approval of the Central Government. SEBI has also been empowered to impose monetary penalties for a wide range of violations, and accordingly the SEBI Act provides for adjudication and empowers SEBI to appoint adjudicating officers. The amended Act also envisages the establishment of Securities Appellate Tribunal to be set up by the Government to hear appeals against monetary fines imposed by the adjudicating authority.

4. The Securities Laws Amendment Act, 1995 also made some amendments to the Securities Contracts (Regulation) Act, 1956. Accordingly, Section 20 of the SCR Act which prohibited options in securities has been omitted from the Act. Besides, a new Section has been inserted in the Act which provides that a recognised stock exchange may establish additional trading floor with the prior approval of SEBI. It is expected that this amendment would enable the stock exchanges to set up trading facilities outside their areas of operation in order to provide services to a larger number of investors under a regulatory framework.

5. During the year the following Rules and Regulations under the SEBI Act were notified: (i) Rules on Procedure for Holding Enquiry and imposing Penalties by Adjudicating Officer; (ii) Rules on Securities Appellate Tribunal (Procedure); (iii) Regulations on Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets; (iv) Regulations on Foreign Institutional Investors; (v) Regulations on Payment of Fees (Amendment).

**Box 4.1**
**Capital Market Reforms-General :**
**1992-93 to 1995-96**

- Capital issues (Control) Act, 1947 repealed, office of Controller of Capital Issues abolished, and share pricing decontrolled. The Companies can approach capital market after clearance by SEBI.
- Securities and Exchange Board of India (SEBI) which was established in February 1992 armed with necessary authority and powers for regulation and reform of the Capital Market.
- Through a notification issued under the Securities Contract (Regulation) Act, 1956, the power to regulate stock exchanges, was delegated to SEBI. This includes recognition, rules, articles, voting rights, delivery contracts, stock exchange listing and nomination of public representatives.
- Redressal of complaints of investors is to be encouraged, sharing it with recognised investor associations. This will facilitate filing of class action suits in consumer courts against erring companies.
- Foreign Institutional Investors (FII's) allowed access to Indian capital markets on registration with SEBI. 337 FII's have been registered by December 1995.
- Investment norms for NRI's liberalised, so that NRI's and overseas corporate bodies can buy shares and debentures with prior permission of RBI.
- Indian Companies permitted to access international capital markets through Euro- equity shares.
- SEBI's autonomy reinforced by allowing it to issue regulations and file suits without prior approval of the Central Government.
- Over the Counter Exchange of India (OTCEI) and the National Stock Exchange of India with nation wide stock trading and electronic display, clearing and settlement facilities, commenced operations.

**Box 4.2**
**Primary Market Reforms : 1992-93 to 1995-96**

- Merchant banking brought under SEBI regulatory framework and a code of conduct issued.
- The 'Banker to the issue', brought under purview of SEBI for investor protection.
- The due diligence certificate by lead managers, regarding disclosures made in the offer document, has been made a part of the offer document itself for better accountability.
- SEBI has prescribed improved disclosure standards, introduction of prudential norms and simplification of issue procedures.
- Companies required to disclose all material facts and specific risk factors associated with their projects while making public issues.
- Stock exchanges required to ensure that companies concerned have a valid acknowledgment card issued by SEBI. SEBI vets the offer document, to ensure that all disclosures have been made by the company in the offer document, at the time the company applies for listing of its securities in the stock exchange.
- Stock exchanges advised to amend the listing agreement to ensure that a listed company furnishes annual statement to stock exchanges, showing variations between financial projections and projected utilisation of funds made in the offer documents and actuals.
- To discourage the use of stock-invest by institutional investors, the facility has been restricted to mutual funds and individual investors.
- SEBI introduced a code of advertisement for public issues for ensuring fair and truthful disclosures.
- To reduce the cost of issue, underwriting by issuer made optional, subject to the condition that if an issue was not underwritten and was not able to collect 90 per cent of the amount offered to the public, the entire amount collected would be refunded to investors.
- The extant guidelines for bonus shares have been relaxed.
- The practice of making preferential allotment of shares at prices unrelated to the prevailing market prices was stopped and fresh guidelines were issued by SEBI.
- An Expert Committee chaired by Shri Y.H. Malegam reviewed the existing disclosure requirements and issue procedures, and suggested actions, based on which new guidelines were issued.
- SEBI to vet the draft prospectus within 21 days and mandatory period between the date of approval of the prospectus by the Registrar of companies and the opening of the issue to be reduced to 14 days.
- The details of abridged prospectus to be scruitinised by SEBI before the issue of acknowledgement card.
- SEBI reconstituted governing boards of the stock exchange, introduced capital adequacy norms for brokers and made rules for making the client/broker relationship more transparent, in particular, seggregating client and broker accounts.

**Box 4.3**
**Secondary Market Reforms :**
**1992-93 to 1995-96**

- SEBI introduced regulations governing substantial acquisition of shares and takeovers and lays down conditions under which disclosures and mandatory public offers are to be made to shareholders.
- 'Renewal' of transactions in 'B' group securities prohibited, so that transactions can be settled within 7 days.
- Private mutual funds permitted and several have already been set up. All mutual funds allowed to apply for firm allotment in public issues.
- UTI brought under the regulatory jurisdiction of SEBI.
- Fresh guidelines for advertising by mutual funds issued and the requirement of pre-vetting of advertisements removed .
- To improve the scope of investments by mutual funds, mutual funds permitted to underwrite public issues and guidelines for investment in money market instruments relaxed.
- The procedure for lodgement of securities for transfer was considerably eased for institutions through the introduction of 'jumbo' transfer deed and consolidated payment of stamp duty.
- Stock exchanges would be allowed to introduce carry forward system only with the prior permission of SEBI and subject to effective monitoring and surveillance system, and infrastructure.
- The financiers funding the carry forward transactions being lenders of funds will not be permitted to square up their positions till repayment of the loan.
- The carry forward position shall be disclosed to the market, scrip-wise and broker-wise by the stock exchanges at the beginning of the carry forward session.
- Capital adequacy norms of 3 per cent for individual members and 6 per cent for corporate members in their outstanding positions announced.
- Graded margins of 20 per cent to 50 per cent on carry forward transactions were replaced by those suggested by Patel Committee.
- Members doing financing of carry forward transactions will be subject to a cap of Rs.10 crores.
- The Depositories Ordinance promulgated in September 1995 to provide a legal framework for the establishment of depositories to record ownership details in book entry form.
- The Ordinance proposed to make consequential changes in legislations like the Companies Act, Income Tax Act, SCRA the Stamp Act etc. It provides for detailed regulations to be framed by SEBI as well as detailed bye-laws to be framed by depositories with the approval of SEBI.

The Regulations on Prohibition of Fraudulent and Unfair Trade Practices, inter alia, prohibit manipulation of prices in the stock market, making misleading statements to induce sale or purchase of securities and unfair trade practices relating to securities. These regulations would promote the orderly working of the securities market.

### Prohibition of Fraudulent and Unfair Trade Practices

6. Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets) Regulations, 1995 was notified in October, 1995. This defines, fraudulent and unfair trade practices relating to the securities markets, and vests SEBI with powers to take action against these practices. The regulations bring, for the first time, enforcement against market manipulation, misleading statements to induce sale or purchase of securities and unfair trade practices under SEBI's regulatory purview.

7. The Regulations give SEBI powers to investigate into the affairs of any person buying, selling or otherwise dealing in securities, on whom it has been made obligatory to produce all books, documents and records that are sought by the investigating authority. The Regulations also permit SEBI to issue directions which disallow any person from dealing in securities, to prohibit the disposal of securities.

### Inspection and Enforcement

8. An Amendment to the SEBI Act in 1995 has given SEBI the powers of a Civil Court under the Code of Civil Procedure in respect of discovery and production of books, documents, records and accounts, summoning and enforcing attendance of persons and examining them on oath. The Amendment also gives it powers to levy fines for violations related to the failure to submit information to SEBI, failure to enter into agreements with clients, failure to redress investor grievances, for violations by mutual funds, violations by stock brokers,

violations of insider trading regulations and violations of the takeover regulations. SEBI has also initiated investigation in response to investor complaints or suo moto wherever violations have been noticed. The action taken by SEBI include launching of prosecution proceedings against certain companies, issuing of show cause notices or initiation of prosecution, suspension, issue of show cause notices and warnings to a large number of merchant bankers, rejection of renewals for registration of share transfer agents, suspension of stock brokers and initiation of enquiry proceedings, show cause notices to mutual funds, inspection of Unit Trust of India for the first time, investigation against price rigging in a number of cases and investigation for alleged violations of SEBI Regulations for Substantial Acquisition of Shares and takeovers.

## Primary Market Reforms

9. SEBI undertook a number of primary market reform measures with a view to protecting the interests of investors. The roles and responsibilities of various market participants were reviewed, and disclosure was increased. The use of stock invest facility was restricted to mutual funds and individual investors. The disclosure requirements in offer documents, were further strengthened.

### Disclosure Requirements

10. A Committee under the chairmanship of Sh. Y. H. Malegam was appointed in March, 1995, to review the norms related to disclosure in offer documents and to suggest modifications needed for investor protection. The recommendations were considered in September 1995 and guidelines issued. These cover unlisted companies, finance companies, enhanced transparency in the draft prospectus filed with SEBI, requirements in prospectus submitted to SEBI for vetting, and the book building options.

11. An unlisted company, in a commercial operation for less than two years, and proposing a public issue leading to a post-issue paid up capital of Rs. 3 crore to Rs. 5 crore can seek listing only on stock exchanges with screen based trading. Unlisted companies whose post-issue paid up capital would be less than Rs. 3 crore remain eligible to list on OTCEI.

12. Finance companies would be eligible to make an issue only if they have a minimum track record of two years of operations or they have been granted registration as a non-banking finance company by the RBI, or as an intermediary by SEBI.

13. The draft prospectus filed with SEBI would be made a public document to enhance transparency. The lead merchant banker shall simultaneously file copies of the draft document with the stock exchanges where the issue is proposed to be listed.

14. Every prospectus submitted for vetting shall, in addition to the requirements of schedule II of the Companies Act, contain/specify, inter-alia, the following. (a) Details of actual expenditure incurred on the project ( where applicable) not earlier than 2 months of filing the prospectus with SEBI or the Registrar of Companies, which ever is later. (b) Means and source of financing and year-wise break-up of proposed project expenditure. (c) The turnover, in the profit/loss statement, shall be bifurcated into manufactured products and traded products, and details of products normally not traded shall be mentioned separately. (d) The companies undertaking major expansion must give details of technology, market, competition, managerial competence and capacity build-up. (e) Projections of future profits allowed by a new company, and by an existing company undertaking a new project or proposing to expand beyond 100 per cent of existing capacity. (f) Details of aggregate shareholding of the promoter group and their directors, where the promoter is a body corporate. (g) Aggregate of securities purchased or sold by the promoter group six months preceding the filing of draft prospectus and the same to be updated till the time of filing the prospectus with the Registrar of Company. (h) The maximum/minimum price at which sales/ purchases, mentioned in (g) above take place. If it is not possible to obtain information regarding sales and purchases of any relative of the promoters, a statement to that effect should be made in the prospectus and disclosures be made in the prospectus on the basis of the transfers recorded in the books of the company. (i) Management perception of the internal and external risk factors and management analysis of the financial condition and results of the operations as reflected in the financial statements.

15. In an issue of securities to the public through a prospectus, the option of book building shall be available to the issuer company subject to the following main conditions: (a) The size of issue exceeds Rs.100 crore. (b) Only as an alternative to and to the extent of, the percentage of the issue which can be reserved for firm allotment, as per the existing guidelines. (c) Book-building process to be separately identified/ indicated as a placement portion category, in the prospectus. (d) Underwriting will be mandatory to the extent of the net offer to the public. (e) One of the lead merchant bankers to the issue shall be nominated by the issuer company as a Book Runner and his name shall be mentioned in the draft prospectus submitted to SEBI.

## Primary Market Developments

16. During 1995-96 upto December, the total value of issues launched was Rs.14155.35 crore,

TABLE 4.1
Analysis of Issues Launched

(Rs.Crore)

| Types of Issues | 1993-94 | | 1994-95 | | 1994(Apr.-Dec.) | | 1995(Apr.-Dec.) | |
|---|---|---|---|---|---|---|---|---|
| | No | Amount | No | Amount | No | Amount | No | Amount |
| Rights | 370 | 8922.86 | 324 | 6576.64 | 219 | 4137.35 | 185 | 4443.01 |
| Public | 773 | 15449.1 | 1342 | 21044.45 | 825 | 9633.40 | 925 | 9712.34 |
| Total | 1143 | 24371.96 | 1666 | 27621.09 | 1044 | 13770.75 | 1110 | 14155.35 |

marginally higher than the Rs.13770.75 crore of issues launched during the corresponding period of 1994-95. The total number of issues at 1110 was also higher then 1044 launched last year (Table 4.1). Consequently the average size of issue this year was Rs.12.75 crore, as against Rs.13.19 crore in the corresponding period of last year. There was also a small shift away from public to rights issue, with the latter rising from 30 per cent to 31.4 per cent in value.

17. For 1994-95 as whole, a total of 1666 issues were launched raising an amount of Rs. 27621.1 crore from the market. Around 80 per cent of these issues were public issues and the rest were rights issues. The average size of Rs. 16.6 crore of Capital issue for the whole of 1994-95 was higher than Rs.13.19 crore during April-December, 1994. The average size of the public issue at Rs.10.50 crore during April-December, 1995 was, however, lower than the Rs.11.68 crore observed during April-December 1994. The average size of rights issues at Rs.24.02 crore during April-December 1995 was significantly higher than the average size of the rights issue of Rs.18.89 crore during April-December 1994.

## Secondary Market Reforms

### Carry Forward

18. The Patel Committee Report on the carry forward system was discussed by a wide section of market participants. SEBI after taking into account the views expressed, considered the report in its board meeting held on July 27, 1995. It was decided to introduce a revised carry forward system subject to the following prudential conditions and precautions:

(a) Stock Exchanges would be allowed to introduce carry forward system only with the prior permission of SEBI. Screen based trading and systems capability for effective monitoring and surveillance would be a pre-requisite. Executive Director would be responsible for monitoring, surveillance and reporting and he must be empowered in this regard, if necessary, by change of bye-laws, rules and regulations of the exchange. The exchanges would also ensure the submission of timely and regular information to SEBI about various parameters and their implementation.

(b) The transaction would be allowed to be carried forward for a period not exceeding 90 days. While the transactions would be allowed to be squared off upto 5th settlement (75th day), transaction remaining unsettled till this day, will have to be settled by delivery or payment, as the case may be.

(c) The financiers funding the carry forward transactions being lenders of funds should not be permitted under any circumstances to square up their positions till repayment of the loan. The shares received by such financiers against those transactions should be deposited and kept in safe custody of the clearing house of the stock exchange or its authorised agent.

(d) Vandhas or objection memos would be rectified immediately and the Kapli system and Chalu Upla transactions will not be permitted.

(e) Every member would be required to keep books of record of the source of finance with sub-accounts being maintained in the clearing house.

(f) The carry forward position shall be disclosed to the market, scrip-wise and broker-wise by the stock exchanges at the beginning of the carry forward session.

(g) The brokers must ensure segregation of client account and own account in accordance with the existing guidelines issued by SEBI.

(h) The stock exchanges would be introducing the capital adequacy norm of 3 per cent for individual brokers and 6 per cent for corporates to begin with.

(i) The various margin requirements both for daily and additional for volatile scrips would be levied on a weekly marked to market basis. The Bombay Stock Exchange has since set up systems to introduce revised carry forward transactions, after taking the prior approval.

19. In 1995-96, SEBI has initiated several measures in conjunction with the stock exchanges to increase investor protection in the secondary market, and to ensure that the transparency and efficiency of markets increase.

### Monitoring of Price Manipulation

20. A division has been set up within SEBI to monitor unusual movements in prices in co-ordination with the stock exchanges, which are to set up dedicated surveillance departments. SEBI has initiated investigation in several cases where market manipulation was suspected. The exchanges' mechanisms for monitoring and taking pre-emptive action in cases where unusual rise in prices are noticed are also sought to be strengthened as follows:

(1) The stock exchanges are to start monitoring the prices of newly listed/permitted scrips from the first day of trading. If necessary, circuit breaker system and other market monitoring restrictions would apply from second day of trading. Stock exchanges agreed because of the possible misuse of the 4 days currently available for price formatiön and stabilisation.

(2) In case of newly listed/permitted scrips, where there is abnormal price variation, the exchanges would impose a special margin of 25 per cent or more on purchases in addition to the regular margin. The seller would also be required to pay a penal margin equivalent to the special margin (applicable to buyers) on the undelivered quantity. Such penal margin would be retained by the exchanges for a period of three months or one month after the delivery, whichever was earlier. In case of non-delivery, the usual auction procedure would also be applicable. The special/penal margin would apply to all scrips where price manipulation is noticed.

(3) The suspension of trading on account of market manipulation or price rigging is to be immediately advised by the concerned stock exchange to other stock èxchanges who would also suspend the trading in that scrip. This would apply to cases where the suspension is for more than a day.

(4) In order to achieve effective co-ordination between the exchanges as well as to evolve uniform policies on matters of general interest as well as market operations, and specifically surveillance and market monitoring, an Inter-Exchange Co-ordination Group (ICG) would be set up. All the exchanges would be members of the group. The first executive committee of the group would comprise of representatives of Ahmedabad, Bombay, Calcutta, Delhi, Madras, OTCEI, and National Stock Exchange and one representative from the stock exchanges in each region, that is, Cochin, Kanpur, Bhubaneshwar and Pune.

### Market Infrastructure and Systems

21. NSE, OTCEI and BSE have already introduced screen based trading. All other exchanges except Guwahati, Magadh and Bhubaneshwar are to introduce full computerisation and screen based trading by June 30, 1996. This will bring about a greater transparency for investors, reduced spreads, more effective monitoring of prices and volumes and speedy settlement.

22. In the interest of investors, the amount of compensation against a single claim of an investor arising out of default by a member-broker of the stock exchange from the Investor Protection Fund is to be raised to Rs.1 lakh in case of major stock exchanges. In others, it would be raised to Rs. 50,000, except in case of smaller stock exchanges like Guwahati, Bhubaneshwar, Magadh and Madhya Pradesh, where the amount is to be Rs.25,000.

23. The major stock exchanges are to set up Investor Information Centres to provide information about investors' rights and obligations and about their listed companies. The stock exchanges are to evolve uniform norms for good and bad delivery and procedure for rectification of the same. This exercise is to be undertaken by the Inter-Exchange Co-ordination Group.

### Capital Adequacy and Insurance

24. Capital adequacy of all securities market intermediaries are to be gradually raised to the norms prescribed by the International Organisation of Securities Commissions (IOSCO) of which SEBI is a member. A beginning was made with the amendment to the Securities Contracts (Regulation) Rules, 1957 which allowed for the corporate membership of stock exchanges. Corporatisation and limited liability has acted as an incentive for stock brokers to retain capital in their businesses. Non-citizens can now be on the board of directors of corporate broking firms. Corporate brokers can now have multiple memberships of stock exchanges subject to their separately fulfilling the capital adequacy requirements of each exchange. With these relaxations, several foreign securities firms have invested in domestic corporate broking firms. Further, the number of corporate brokers increased from 143 in March 1995 to 616 in December 1995.

25. Capital is only one of the methods for protecting market intermediaries, and consequently investors, from default and other risks. Therefore, the stock exchanges are to ensure that by June 30, 1996, all member brokers are insured, so that they are better able to protect against risk, thus protecting them from an erosion of capital.

### Depositories

26. The Depositories Ordinance promulgated in September 1995 will provide a legal framework for establishment of depositories to record ownership details in book entry form. It provides for establishment of depositories subject to registration

with SEBI. SEBI will prescribe conditions to be made before Certificate of Commencement of Business can be issued. Investors will have the choice of continuing with the existing share certificates or opt for the depository mode. Investors opting to hold securities in 'dematerialized' form will be required to go through a 'participant' in the depository, who would also be registered with SEBI. Participants will be agencies such as banks, financial institutions, custodians of securities and stock brokers. Upon entry into the system, share certificates will be 'dematerialized' and the names of beneficial owners would be registered as such on the books of depository, or of participants, who would be the agents of the depository.

27. Issuers of new securities will give investors the option either to receive physical securities or to join the depository mode. While investors holding share certificates may opt to become beneficial owners in a depository system, those investors opting to exit from a depository will be allowed to do so and claim share certificates from the company by substituting their names as the registered owner in the place of the depository.

28. Ownership changes in the depository system will be made through electronic book entry transfers. There will be a regular, mandatory flow of information about the details of ownership in the depository's record to the company concerned. If the latter has any reservations about the admissibility of share acquisition by any person on the grounds that the transfer of the security conflicts with the provisions pertaining to substantial acquisition of shares and takeovers, or conflicts with the provisions of the Sick Industrial Companies (Special Provisions) Act, the company will be entitled to make an application to the Company Law Board (CLB) for rectification of the ownership records with the depository.

29. The Ordinance has prescribed certain rights and obligations of depositories, participants, issuers of securities and beneficial owners. Further rights and obligations would be specified in SEBI regulations for depositories and participants. The Ordinance has also prescribed certain issues relating to the interface between depositories, participants and beneficial owners that would be dealt with in the bye-laws of the depository to be approved by SEBI.

30. The Ordinance has proposed to make consequential changes in legislations like the Companies Act, Income Tax Act, the Securities Contracts (Regulation) Act, the Stamp Act etc. In respect of Stamp Act, transfers of ownership of shares through the depository electronic book entry system will become exempt from payment of stamp duty.

31. The Depository Ordinance does not specify any particular changes in the present clearance and settlement system. The introduction of electronic book entry transfer in a depository will eliminate the need for physical movement of securities in the transfer process, which, at present is a significant bottleneck. It will therefore, considerably enhance the efficiency of the securities market and offer benefits to investors in the form of greater accuracy and safety in share transactions, improved liquidity of secondary market transactions and better means of ownership change. The full benefits of depository system can however, only accrue if clearance and settlement systems are also modernised.

32. Towards this end, the exchanges have been directed to automate their operations, reduce the settlement cycle, and set up a Clearing House or Clearing Corporation by June 30, 1996. Direct delivery of shares from broker to broker, which involve counter-party risk would be replaced by contract between the Clearing House and brokers. This would reduce the risk and help shorten settlement cycles.

33. IDBI and UTI along with NSE are also working on setting up a depository which will enable investors to settle trades through electronic book entry adjustment, drastically reducing over time, the risks associated with paper based settlement systems.

### Takeovers Code

34. SEBI (Substantial Acquisition of Shares and Takeovers) Regulations were notified in November, 1994 bringing all parties in a substantial acquisition under SEBI's regulatory umbrella. The regulations set out a procedure for substantial acquisition of shares. This will protect the rights of minority shareholders providing an exit route at a price which is fair and transparent.

35. In 1995-96, 14 offers were made under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1994, upto December. As the Indian economy becomes more dynamic in its response to internal and external changes, corporate restructuring is likely to become more prevalent. and takeover activity to increase. SEBI has, therefore, set up a Committee under the chairmanship of former Chief Justice. Shri P.N. Bhagwati to examine afresh the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations. 1994 in November 1995.

### Recent Changes

36. The Securities and Exchange Board of India had suggested the setting up of a Committee to formulate steps to improve the functioning of the BSE. Further, SEBI directed the BSE to implement the recommendations of the Limaye Committee

Report (June, 1995) which, inter-alia, had suggested that the margins mechanism be strengthened and settlements be completed on a weekly basis. This report is at present being examined by SEBI.

## Secondary Market Developments

37. After falling sharply over the second half of 1994-95, the BSE Sensex has broadly stabilised over this year. There have, of course been fluctuations during the year. BSE Sensex rose gradually from 3408.29 in March, 1995 to 3528.10 during October 1995. It has declined since then (Table 4.2, Fig. 4.1). BSE National Index has shown similar behaviour during this period . The index stood at 1631.55 in April 1995, 1550.57 in July 1995 and it rose marginally to 1603.84 in October 1995. It is

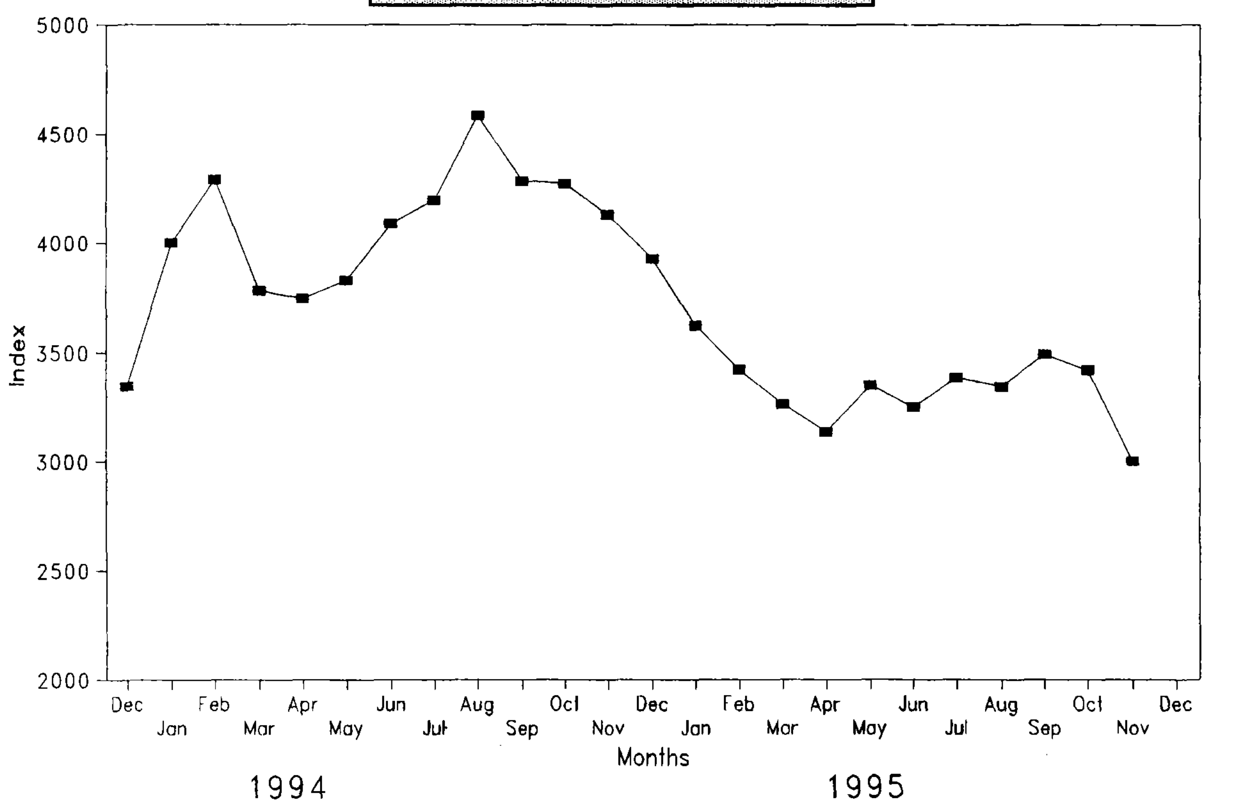
**TABLE 4.2**
**Trends in selected stock market indicators**

| Indicators | 1994 April | 1994 December | 1995 April | 1995 December |
|---|---|---|---|---|
| a) Index[1] | | | | |
| Sensex | 3824.75 | 3949.78 | 3359.27 | 3060.05 |
| National Index | 1855.81 | 1876.13 | 1631.55 | 1406.95 |
| b) Price/Earn. Ratio | | | | |
| Sensex | 46.43 | 34.5 | 27.84 | 15.99 |
| National Index | 46.45 | 38.58 | 31.84 | 16.95 |
| c) Average Daily Turnover (Rs. Crore) | 206 | 423 | 127 | 238.43 |
| d) Market Capitalisation (Rs. Crore)[2] | 364868 | 400000 | 455315 | 644678 |

[1] Average for the month, [2] estimated

Fig 4.1

BSE Sensex of Share Prices (Base 1978-79 = 100)



recognised by the Government and SEBI that the stock markets generally fluctuate due to the interplay of a variety of factors. It is recognised that the main concern of policy must be to ensure that stock markets operate in a transparent manner, without fraudulent manipulation, and with full compliance of regulatory rules. It has been the objective of policy to strengthen the institutional structure of stock markets by improving the systems of trading and settlement, modernising stock market practices, and in general establishing a regulatory framework which corresponds with accepted international practices. This is necessarily a continuous process.

38. There has been a gradual uptrend in turnover in 'A' group shares during 1995-96, while 'B' group shares have shown greater fluctuations. Nevertheless, during the current year, total turnover in (A + B) groups after showing a rising trend during the early part of the year, shows a flat trend line for the subsequent period.

39. Total turnover stood at Rs.2024 crore in April 1995, Rs.4836 crore in July 1995, fell marginally to Rs.4149 crore in August 1995 and rose to Rs.4657 crore in October 1995. The volume of turnover in specified shares ('A' group) on the other hand increased almost four- fold between April and October 1995 to touch Rs.2373 crore in October 1995. The volume of turnover in specified shares ('A' group) had reached a high of Rs.2935 crore in July 1995. The volume of turnover in non-specified securities ('B' group) rose from Rs. 1384 crore in April 1995 to Rs.3289 crore in September 1995 and Rs.2284 crore in October 1995. The volume of turnover in this group is substantially lower than the volume of turnover in the corresponding months of 1994 (January-December).

40. The problems regarding issue of duplicate shares by companies and the replacement of share certificates sent by buyers for transfer to companies or their share transfer agents by another set of share certificates with different distinctive numbers commonly referred to as "switching of shares", came to light and raised concerns about the integrity of the market. The Government ordered a joint enquiry by the Department of Company Affairs and Securities and Exchange Board of India (SEBI) into these problems. The enquiry will cover top companies, their share transfer agents, custodians and other institutions affected by this problem. The final report of the enquiry is awaited.

41. Thus, during the first three quarters of 1995-96 the securities market was characterised by low level of share price indices and market turnover. The present bearish phase must be viewed in a longer time frame for a meaningful assessment of the situation. The subdued conditions in the stock market have continued along-side signs of industrial recovery, and generally good corporate results.

### National Stock Exchange of India

42. National Stock Exchange was set up in 1993 to encourage stock exchange reform through system modernisation and competition. The reach of NSE has been extended to twenty one cities of which six cities, do not have stock exchanges of their own. By end 1996, NSE has planned to extend its network to over 40 cities spread across the country. It is an electronic screen based system where members have equal access and equal opportunity to trade irrespective of their location in different parts of the country as they are connected through a satellite network. The system helps to integrate the national market and provide a modern system with a complete audit trail of all transactions. Instantaneous matching of trades effectively prevents circular trading which has been one of the mechanism of pre-rigging. The number of members trading on the exchange has increased from 227 members at commencement to 600 members as of November 1995. In addition, many members are taking on authorised dealers so that the benefits of NSE can spread far and wide.

43. The debt market which provides trading facilities for the whole range of debt instruments is still in its infancy with average daily activity in this segment varying between Rs.35 crore to Rs. 40 crore. Instruments traded include, government securities, treasury bills, public sector bonds, institutional bonds, commercial paper, and corporate debentures. It is characterised by large participants such as banks and institutions. On the capital market segment, activity has grown phenomenally over the 14 months with daily average volumes increasing from Rs.7 crore in November 1994 to Rs.370 crore in December 1995 with the number of trades increased from 900 per day to 36000 per day. The total number of securities available for trading on the exchange has increased to 1350.

44. The capital market segment follows a weekly settlement cycle with all settlements completed within seven days of the last trading day of the cycle. The exchange has completed 59 settlements and during this period the volume of settlements has consistently increased and now averages at nearly Rs.250 crore per settlement. The percentage of short deliveries and unrectified bad deliveries have been consistently very low. This is mainly due to the strict adherence to settlement schedules which the exchange effects through a penalty points system. Further, the exchange follows an auctioning mechanism where all shortages on securities and funds are immediately auctioned automatically on the day following pay in, which ensures that all settlements go through smoothly.

45. In its effort to further improve the settlement system and minimise risks associated therein, NSE has set up a subsidiary - National Securities Clearing Corporation (NSCC). On par with clearing corporations world over, NSCC will shortly guarantee settlement of trades executed and settled through it. NSE is working on a plan for setting up of a separate derivatives trading segment which will provide members an organised and safe mechanism to hedge risks.

### Foreign Institutional Investors

46. The opening up of the stock market to FII investment in 1992-93 led to a surge of FII inflows amounting to Rs.5126 crore in 1993-94. This represented a diversification of the portfolio of international investors into India, one of the emerging markets. This process of stock adjustment is more clearly seen in the quarterly data (Table 4.3) for the four quarters starting October 1993, that is, October 1993 to September 1994. International developments resulted in slowing down of the stock adjustment process in October 1994, with the result that total inflows in 1994-95 at Rs.4796 crore were 6.4 per cent lower than in 1993-94. During 1995-96 upto December 31, 1995, net investment by FII's in Indian securities markets was Rs.3304 crore. This was 22 per cent lower than the corresponding figure of Rs.4247 crore for 1994-95. The decrease in FII investments in Indian securities markets during 1995-96 was in line with the experience of other emerging markets, which also saw a decline in portfolio inflows. Net FII investment has, however, been positive in every single month.

47. The quarterly pattern of inflows during 1995-96, however, shows a clear recovery of growth. Net FII investments during the first quarter of 1995-96 at Rs.765.8 crore were 65.5 per cent lower than in the first quarter of 1994-95. This trend in net investments was totally reversed during the second quarter. Net investments rose from Rs.1383.5 crore during July-September, 1994 to Rs.1626 crore during July-September, 1995 showing a rise of 17.5 per cent. The growth rate accelerated to 41.3 per cent in the third quarter, with net investments rising from Rs.645.5 crore in the third quarter of 1994-95 to Rs.912 crore during the third quarter of 1995-96 (Table 4.3).

TABLE 4.3
Net Investment by FIIs : 1992-93 TO 1995-96

| Period | Amount (Rs.Crores) | Per cent increase[1] |
|---|---|---|
| 1992-93 | | |
| Jan.-March | 13.4 | - |
| 1993-94 | | |
| Apr.-June | 149.7 | - |
| Jul.-Sept. | 552.7 | - |
| Oct.-Dec. | 1879.5 | - |
| Jan.-March | 2544.6 | - |
| 1994-95 | | |
| Apr.-June | 2217.7 | 1381.4 |
| Jul.-Sept. | 1383.5 | 150.3 |
| Oct.-Dec. | 645.5 | -65.7 |
| Jan.-March | 549.6 | -78.4 |
| 1995-96 | | |
| Apr.-June | 765.8 | -65.5 |
| Jul.-Sept. | 1626.0 | 17.5 |
| Oct.-Dec. | 912.0 | 41.3 |

[1] per cent increase over the corresponding period of the previous year.

48. FII Investment in Indian securities markets has been quite diversified, with investment in over 600 securities. In 1995-96 upto December, FII investments were largely inactive in Sensex stocks, with most of the activity coming from 'B' Group stocks.

49. The Regulations on Foreign Institutional Investors, which were notified on November 14, 1995, contain various provisions relating to definition of Foreign Institutional Investors (FII's), eligibility criteria, investment restrictions, procedure of registration and general obligations and responsibilities of FII's. According to the Regulations, FII's may invest only in (a) Securities in the primary and secondary markets including shares, debentures and warrants of companies listed or to be listed on a recognised stock exchange in India; and (b) Units of schemes floated by domestic mutual funds including Unit Trust of India, whether listed on a recognised stock exchange or not.

50. Joint ventures between a variety of domestic and foreign securities firms have been approved in the stockbroking, merchant banking, assets management and other non bank financial services sectors. The overall effect of FII investment and financial joint ventures has been the introduction of international practices and systems to the Indian securities industry.

### Global Depository Receipts

51. Foreign portfolio investment has also taken place through Euro issues of Global Depository Receipts (GDR's) and Foreign Currency Convertible Bonds (FCCB's). Upto December 1995, Indian firms had raised $ 5180.9 million through 64 issues of GDR's and FCCB's. This was 24 per cent higher than the net cumulative investment by FII's upto December 1995, of $ 4184 million. During 1994-95, $ 2029 million were raised through 29 Euro Issues. In 1995-96 upto December, the number of Euro issues had declined by 86 per cent compared to the corresponding period of 1994-95, from 28 to 4.

The amount raised by Euro issues showed a similar decline of 88 per cent from $ 1891 million to $ 221 million.

### International Comparison

52. The total market capitalisation of the Indian stock market was $ 138.6 billion. This was the sixth highest among the emerging markets after Taiwan, Malaysia, S. Africa, Korea and Brazil. The number of companies listed on the BSE at the end of December, 1994 was 4702. This was more than the aggregate total of companies listed in nine emerging markets (Malaysia, S. Africa, Mexico, Taiwan, Korea, Phillipines, Thailand, Brazil and Chile). The number of listed companies was also larger than in the developed country markets of Japan, UK, Germany, France, Hong Kong, Canada, Australia and Switzerland. The turnover ratio of the Bombay Stock Market (15.6 per cent) was also greater than that of Chile (9.5 per cent) and South Africa (8.5 per cent). It was, however, less than that of seven other emerging markets such as Thailand (60.9 per cent), Malaysia (58.7 per cent), Taiwan (323.1 per cent) and Korea (174.1 per cent).

## Gilt-edged Market

### Reforms

*Delivery versus Payment System*

53. RBI introduced in July 1995, in Bombay, a Delivery Versus Payment (DVP) system for transactions in Government securities. The DVP system ensures clearing and settlement, by synchronizing the transfer of securities with the cash payment. This reduces settlement risk in securities transactions and also prevents diversion of funds through SGL transactions. RBI has also advised banks not to use brokers for inter-bank transactions but to trade directly. They can, however, undertake securities transactions among themselves or with non-bank clients through members of the National Stock Exchange of India.

*Primary Dealers*

54. The Reserve Bank of India announced on March 29, 1995, the guidelines and procedure for enlistment of primary dealers in the Government securities market. It accorded 'in principle' approval to six entities on November 13, 1995. The system

**Box 4.4**

**Reforms in the Government Securities Market : 1991-92 to 1995-96**

- 364 day treasury bills replaced 182 day treasury bills in 1992-93 and are sold by fortnightly auctions, since April 1992.
- Auction of 91 day treasury bills commenced from January 1993.
- The system of switch quota for banks and financial institutions discontinued since April 1992.
- Maturity period for new issues of Central Government securities shortened from 20 to 10 years. Maturity of State Government securities shortened from 15 to 10 years.
- Funding of Auction treasury bills into a fixed coupon dated security at the option of holders introduced since April 19, 1993.
- Five new instruments introduced (a) Zero coupon bonds on January 18, 1994, (b) Tap-stock on July 29, 1994, (c) Partly-Paid government stock on November 15, 1994, (d) Another instrument, combining the features of tap stock and partly-paid stock on September 11, 1995, (e) Yet another new instrument of Floating Rate Bonds introduced on September 29, 1995.
- State Government and eligible provident funds allowed to participate in 91 day treasury bills auctions on a 'non-competitive' basis from August 1994.
- Details of transactions in Government securities put through Subsidiary General Ledger (SGL) accounts being published since September 1994 to improve market transparency.
- A scheme for auction of Government securities from RBI's own portfolio as a part of its open market operations announced in March 1995.
- Guidelines for Primary Dealers in Government Securities Market issued in March 1995.
- Funding of treasury bills into a dated security introduced through the auction mechanism in April 1995.
- A system of Delivery versus Payment (DVP) in SGL transactions introduced at Bombay (July 1995).
- RBI offered a select list of securities, depending upon supply and demand conditions instead of offering for sale, most securities from its portfolio.
- Reverse repo facility with RBI in Government dated securities extended to Discount and Finance House of India (DFHI) and Securities Trading Corporation of India (STCI) to provide liquidity support to their operations to stabilise call money rate. The earlier refinance facility to these two institutions for such securities have been withdrawn. Refinance facility against treasury bills, however, continued.

would become operational after the acceptance of RBI's terms and conditions through an agreement. The primary dealers would strengthen securities market infrastructure and bring about an improvement in secondary market trading, liquidity and turnover. They would also ultimately induce voluntary holding of Government securities amongst a wider investor base.

55. RBI would extend to primary dealers, facilities like Current Account/SGL Account, liquidity support linked to bidding commitments, freedom to deal in money market instruments and favoured access to open market operations.

### Market Developments in Government Securities

56. Given tight money conditions arising from a sharp increase in the demand for credit from industry, demand for repos came down significantly in early 1995 and the auctions were, therefore, suspended temporarily from February 1995. Inter bank repo transactions in treasury bills and dated securities approved by the RBI in consultation with the Government, have, however continued, to enable liquidity adjustments in the system. During April-December, 1995 the total size of eligible securities for repo transactions amounted to over Rs.57,000 crore spread over 12 eligible securities.

*Central Government Borrowing*

57. The market borrowing of the Central Government including dated securities and treasury bills, but excluding 'ad hoc' borrowing from RBI indicates the demand put on the capital and money markets. For the period, April-December 1995 the net market borrowings of the Central Government at Rs. 17180 crore were 20 per cent lower than the net borrowing of Rs. 21486 crore in April-December 1994 (Table 4.4). Contrary to popular perception, it was even lower during the first quarter of 1995-96 being 70 per cent lower than in the first quarter of 1994-95. Instead of Government borrowing crowding out, private borrowing, it would be more accurate to say that in the first three quarters of 1995-96 the surge in private demand for credit crowded out Government borrowing from the market.

TABLE 4.4

Net Market Borrowings of Central Government[1]

(Rs. Crore)

| Instruments | 1993-94 | 1994-95 | 1994-95 April-December | 1995-96 April-December |
|---|---|---|---|---|
| a) Conventional Market borrowing | 3700 | 3700 | 3700 | 3700 |
| b) Other medium and long term borrowing | 25127 | 16597 | 14597 | 19879 |
| c) 364 day treasury bills | -391 | -223 | 3189 | -6399 |
| Total | 28526 | 20074 | 21486 | 17180 |

[1] Actuals as per RBI records.

58. The financing pattern has also been different during 1995-96. The most significant change is the rapidly falling contribution of 364 day treasury bills, whose stock declined by Rs. 6399 crore during April-December 1995. This is in total contrast to 1994-95, when the contribution of 364 day treasury bills was Rs.3189 crore during April-December 1994. Medium and long term loans show an opposite pattern, running well above last year's level. During April-December, these loans increased by Rs.19879 crore compared to Rs.14597 crore in 1994-95. Net issue of 91 day treasury bills (on Tap and Auctions) have been substantially higher during 1995-96, Rs.4156 crore up to December 1995 compared to a decline of Rs.4768 crore during 1994-95 (upto December 1994).

59. Around 16.5 per cent of primary issues (excluding conversion) of government securities had to be subscribed by the RBI (between March 31 and December 31, 1995). This is higher than the devolvement of 1.8 per cent in 1994-95 and the 5.5 per cent devolvement in 1993-94.

*364 day Treasury Bills-Auctions*

60. Through 364 day treasury bills auctions, a gross amount of Rs.16857 crore was raised during 1994-95. The rising trend in the cut-off yield on 364 day treasury bills, which started from a low of 9.41 per cent in September 1994 was resumed during 1995-96. From 12.08 per cent in the first auction of 1995-96, cut-off yields rose steadily to reach 13.16 per cent in August 1995. There has been some decline since then, but the rate has stabilised since November at 12.99 per cent. In December end 1995, the interest rate was, therefore, 3.08 percentage points higher than it was 26 fortnights before (December 1994). During 1995-96 (upto December, 1995), the gross issues stood at Rs.1558 crore.

61. The implicit yield at cut-off price ranged between 12.08 per cent to 13.16 per cent, compared to a wider range between 9.41 per cent and 11.94 per cent in 1994-95 (Table 4.5). The number of bids received for 364 day treasury bills varied in the range of 5 to 66 ( upto December 1995) as compared with 18 to 165 (upto December 1994), during 1994-95

*91 Day Treasury Bills-Auctions*

62. The auctions for 91 day treasury bills are conducted weekly and the amount offered is pre-announced. RBI participates as a non-competitive bidder. A gross amount of Rs.12,450 crore was

**TABLE 4.5**
**Implicit yield of 364 Day T-Bills at cut off price**
(Per cent per annum)

| Month | 1994-95 | 1995-96 |
|---|---|---|
| April | 9.97 | 12.08 |
| | 9.94 | 12.21 |
| | 9.87 | |
| May | 9.82 | 12.50 |
| | 9.77 | 12.52 |
| June | 9.82 | 12.52 |
| | 9.99 | 12.60 |
| July | 10.04 | 12.71 |
| | 9.82 | 13.16 |
| August | 9.71 | 13.16 |
| | 9.51 | 12.87 |
| September | 9.41 | 12.87 |
| | 9.41 | 12.87 |
| | | 12.91 |
| October | 9.42 | 12.93 |
| | 9.42 | 12.94 |
| | 9.47 | |
| November | 9.49 | 12.99 |
| | 9.54 | 12.99 |
| December | 9.83 | 12.99 |
| | 9.91 | 12.99 |
| January | 10.56 | 13.07 |
| | 10.86 | |
| February | 11.23 | |
| | 11.48 | |
| March | 11.73 | |
| | 11.84 | |
| | 11.94 | |

raised in 1994-95. During 1995-96 (upto December 1995), the gross amount raised stood at Rs.17,050 crore. The implicit yield at cut-off prices ranged between 11.40 per cent in the last week of April 1995 to 12.97 per cent from mid-November to end -December 1995. The number of bids received for 91 day auction treasury bills varied in the range of 4 and 65 during 1993-94 and between 6 and 82 during 1994-95. During 1995-96 (upto December 1995), it ranged between 5 and 74.

63. The implicit yield at cut-off prices which was on a rising trend in 1994-95 continued on this path during 1995-96. It rose steadily from 11.99 per cent in the first auction of 1995-96 to peak at 12.97 per cent in July (Table 4.6). The subsequent downtrend lasted till the middle of September when it bottomed out at 12.54 per cent. It has risen since then to stabilise at 12.97 per cent in December. There is, therefore, virtually no difference in the cut-off yield of 91 day and 364 day treasury bills suggesting that the liquidity disadvantage is balanced by expectations of inflation/interest rates decline.

**TABLE 4.6**
**Implicit yield of 91 Day T-Bills at cut off price**
(Per cent per annum)

| Month | 1994-95 | 1995-96 |
|---|---|---|
| April | 7.46 | 11.99 |
| | 7.33 | 12.03 |
| | 7.25 | 11.90 |
| | 7.25 | 11.40 |
| | 7.25 | |
| May | 7.21 | 11.95 |
| | 7.50 | 12.07 |
| | 7.58 | 12.07 |
| | 7.75 | 12.07 |
| June | 7.75 | 12.33 |
| | 8.00 | 12.33 |
| | 8.46 | 12.37 |
| | 8.75 | 12.50 |
| | | 12.58 |
| July | 9.08 | 12.71 |
| | 9.08 | 12.97 |
| | 8.91 | 12.97 |
| | 8.58 | 12.75 |
| | 8.75 | |
| August | 8.25 | 12.67 |
| | 8.00 | 12.67 |
| | 8.00 | 12.63 |
| | 8.08 | 12.58 |
| September | 8.08 | 12.54 |
| | 8.08 | 12.54 |
| | 8.41 | 12.54 |
| | 9.08 | 12.67 |
| | | 12.67 |
| October | 9.08 | 12.75 |
| | 9.21 | 12.80 |
| | 9.21 | 12.88 |
| | 8.50 | 12.97 |
| | 8.33 | |
| November | 8.29 | 12.97 |
| | 8.25 | 12.97 |
| | 8.58 | 12.97 |
| | 8.75 | 12.97 |
| December | 9.00 | 12.97 |
| | 9.37 | 12.97 |
| | 9.75 | 12.97 |
| | 9.84 | 12.97 |
| January | 10.26 | 12.97 |
| | 10.51 | |
| | 10.85 | |
| | 10.93 | |
| | 11.10 | |
| February | 11.10 | |
| | 11.23 | |
| | 11.40 | |
| | 11.48 | |
| March | 11.61 | |
| | 11.73 | |
| | 11.82 | |
| | 11.90 | |
| | 11.99 | |

64. While Reserve Bank subscription was practically nil between May 1993 to December 1993, Reserve Bank subscribed in many auctions during the subsequent period upto January 13, 1995 for amounts ranging from Rs.16 crore to Rs.477 crore. During 1995-96 (upto December 1995), the Reserve Bank subscription varied between Rs.31.75 crore and Rs.441 crore. Interestingly, the maximum level of devolution to RBI was high from June to mid-July before the interest peaked in July. This suggests that market conditions eased temporarily from mid-July to September. However, due to tight liquidity conditions, the RBI subscription went up from Rs. 31.75 crore in mid-October 1995 to Rs.291.39 crore in end- December 1995.

## Long Term Debt Market

65. The development of a long term debt market is critical for financing of basic (non-tradeable) infrastructural facilities. The private financing of infrastructure projects also depends upon resolution of a large number of institutional and regulatory issues. The Insurance, Pension and Provident Fund sectors are a major source of long term savings and debt in most countries. The statutory regulations on earmarking the bulk of funds of contractual savings institutions, need to be gradually liberalised. Simultaneously, competitive pressure for efficiency improvements has to be generated so that this freedom is not wasted in inefficiency or monopoly rents.

### Life Insurance Corporation

66. Life Insurance Corporation of India (LIC) is currently required to invest 75 per cent of its funds in Central and State Government securities including government guaranteed marketable securities and in socially oriented sectors, including public and cooperative sectors, and house building by policy holders. Approximately 10 per cent of the funds can be invested in the private sector; 8 per cent as loans to policy holders; 2 per cent for construction and acquisition of immovable property by LIC.

67. During 1994-95, LIC invested Rs.5094 crore in Central Government securities, Rs.982 crore in State Government Securities and Government guaranteed marketable securities and another Rs.1741 crore on disbursing socially oriented sector loans. Against this, Rs.2629 crore were spent on corporate sector investments. There has been a quantum jump in LIC investments in corporate sector from Rs. 1060 crore in 1993-94 to Rs. 2629 crore in 1994-95 (Table 4.7).

### General Insurance Corporation

68. The management of funds by General Insurance Corporation of India (GIC) and its subsidiaries is circumscribed by section 27 (b) of the Insurance Act which describes 'Approved Investments' and Government Guidelines. A general insurance company is permitted to invest up to 25 per cent of total assets in other than approved investment. Government Guidelines further require that 70 per cent of the accretions be invested in Socially Oriented Sector. As recommended by the Committee on Reforms in Insurance Sector this was reduced from 70 per cent to 45 per cent effective April 1,1995.

TABLE 4.7
LIC - Investment Profile

(Rs. Crore)

| INVESTMENT PROFILE | 1993-94 During the year | 1993-94 Outstanding as on 31st March | 1994-95 During the year | 1994-95 Outstanding as on 31st March |
|---|---|---|---|---|
| Central Government Securities | 5449 | 18234 | 5094 | 23089 (41.1) |
| State Government Securities and Government Guaranteed Marketable Sec. | 1107 | 6362 | 982 | 7310 (13) |
| Socially Oriented Sector Loans | 1528 | 9352 | 1741 | 10465 (18.6) |
| Special Deposit with Government of India | 200 | 1698 | 291 | 1839 (3.3) |
| Corporate Sector Investment | 1060 | 7474 | 2629 | 9591 (17.1) |
| Other Investment [1] | 25 | 3441 | 150 | 3888 (6.9) |
| TOTAL | 9369 | 46561 | 10887 | 56182 |

[1] Other Investments include Mortgage Loans under LIC's various Housing Schemes, Policy Loans, House Property, Foreign Investments, etc.
Figs. in parenthesis represent the per cent share.

**Box 4.5**
**Insurance Regulatory Authority**

An interim Insurance Regulatory Authority (IRA) has been set up in pursuance of the announcement made by the Finance Minister in his budget speech, 1995-96. The IRA will be under the administrative control of the Finance Ministry and will have besides chairman, not exceeding seven members to be nominated by the Government. It will evolve the format for effective control over the insurance industry, deal with all matters relating to promotion and orderely growth of insurance market, propose a comprehensive legislation for autonomous IRA conceptually similar to SEBI and carry out such other non-statutory functions as may be delegated by the Government. The interim IRA will also identify the powers which were earlier withdrawn or modified or delegated to LIC and GIC but now need to be restored to the Controller of Insurance. Finally, it will also examine the powers of the government under the insurance Act, 1938 which can be transferred to the IRA.

## Money Market Developments

### Mutual Funds

69. SEBI (Mutual Fund) Regulations, 1993, require an arm's length relationship between the constituents of the Mutual Asset Management Company, the Board of Trustees or Trustee Company and the Custodian. Mutual funds schemes have to be vetted by SEBI, and SEBI has prescribed an advertising code for mutual funds. Private sector companies were allowed to set up mutual funds and foreign participation in asset management companies was allowed. The consequent increase in competition has resulted in an improvement in investor service as mutual funds have, for example, taken to disclosing NAV on a daily basis. It has also resulted in the introduction of various innovative products.

70. Till December 1995, 25 (not including the UTI) mutual funds have been registered with SEBI in terms of the SEBI (Mutual Fund) Regulations, 1993. Of these, 9 are in the public sector and 16 in the private sector. 9 private sector mutual funds and 1 public sector mutual fund have foreign participation in their asset management companies. Schemes offered include equity oriented growth schemes, balanced portfolio schemes, and income schemes. In 1995-96 upto December, Mutual Funds including UTI had raised Rs.1641 crore through 32 new schemes, of which UTI had raised Rs.1307 crore through 7 new schemes. During 1994-95, mutual funds raised Rs.4275 crore through 39 new schemes. Of this Rs.1777 crore was raised by UTI through 9 new schemes.

*Money Market Mutual Funds*

71. In 1995, RBI permitted private sector institutions to set up Money Market Mutual Funds (MMMF's). RBI has since liberalised some of the conditions imposed earlier. Henceforth the size of these MMMF's would not be subject to any ceiling. The minimum size of Rs.50 crore to be subscribed by individual investors for a MMMF has also been removed.

72. The instruments in which money market mutual funds can invest their funds will remain unchanged (namely, treasury bills and dated government securities having an unexpired maturity upto one year, call and notice money, commercial paper, commercial bills accepted / co-accepted by banks and certificates of deposit). The prudential guideline, that the exposure to commercial paper issued by an individual company not exceed 3 per cent of mobilised resources, remains.

*Accounting Policies, Net Asset Values and Pricing*

73. An expert committee on standardisation was set up to prescribe uniform norms for valuation of investments and uniformity of accounting practices. The committee has since submitted its report to SEBI for consideration. SEBI is awaiting comments from market participants on the Committee's recommendations.

### Call Money Market

74. The call money market is the market for very short term funds, known as 'money at call'. The rate at which the funds are borrowed in this market is called Call Money Rate. Call money rates are market determined which are influenced by demand for and supply of short term funds. Out of the total market size of about Rs.6000 — 7000 crore, the public sector banks account for about 80 per cent of the borrowings. The foreign banks and private sector banks account for the remaining 20 per cent. While some banks operate both as lenders and borrowers, others are either only borrowers or lenders in this market. Non-bank financial institutions such as IDBI, LIC, GIC etc. are participating only as lenders in the call money market. The requirement of call money funds upto 20 per cent is met from within the banking system and the balance 80 per cent comes from the non-bank participants.

75. The highest and lowest quotations for the call money rate during the past five years ending with 1994-95 are as follows.

(per cent per annum)

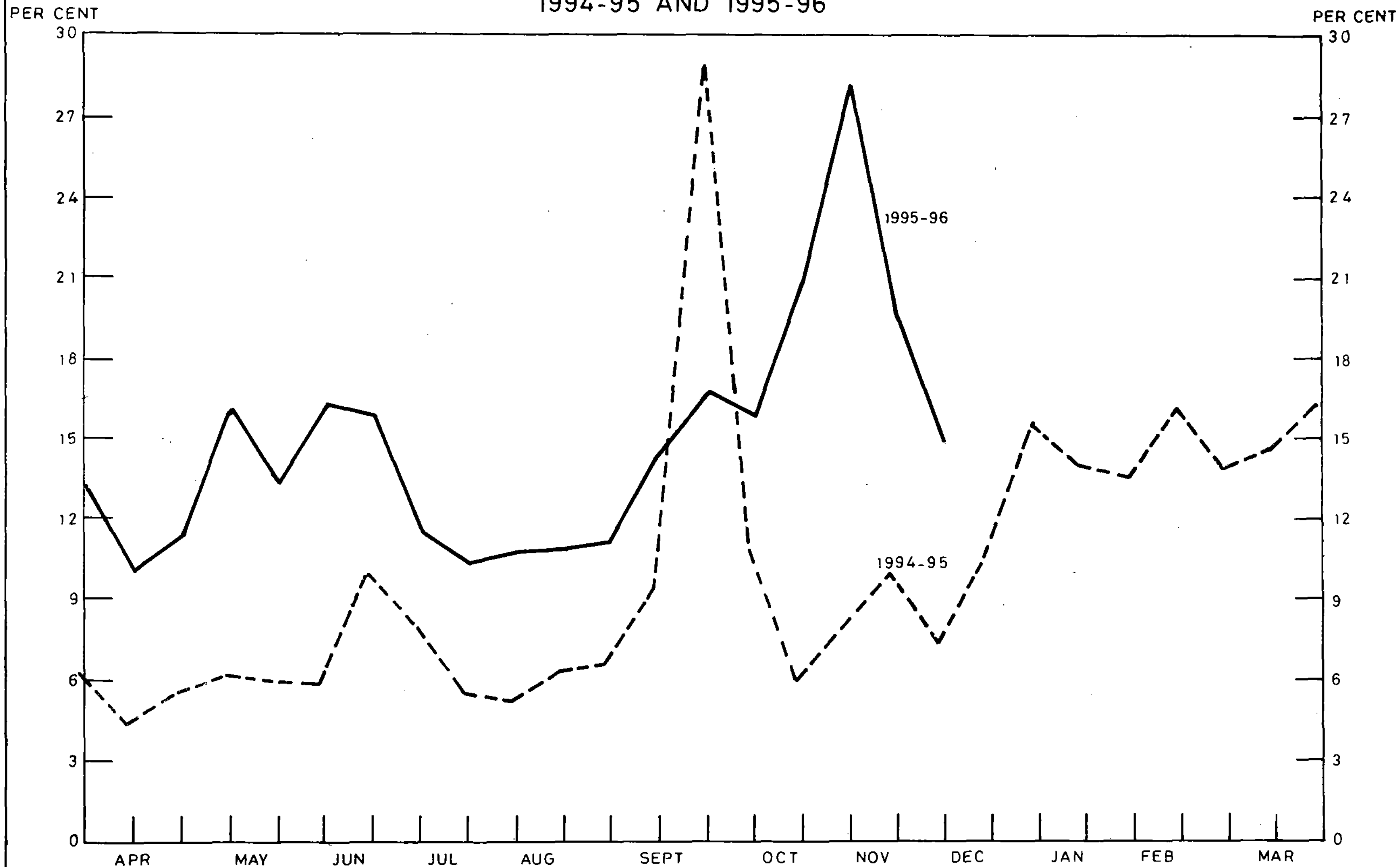
| Year | Highest | Lowest |
|---|---|---|
| 1990-91 | 70.00 | 4.00 |
| 1991-92 | 85.00 | 1.00 |
| 1992-93 | 86.00 | 1.00 |
| 1993-94 | 17.00 | 0.25 |
| 1994-95 | 60.00 | 0.25 |

76. In the current financial year upto January 16, 1996 the highest and the lowest quotations for the call money rate have been 85 per cent and 0.25

Figure 4.2

# INTER BANK CALL MONEY RATE*

1994-95 AND 1995-96




AT THE END OF FORTNIGHTS (ALTERNATE FRIDAY'S)

* DAILY WEIGHTED AVERAGE

per cent respectively. Some stray rates might have been quoted at higher levels but actual transactions at these rates have been for very nominal amounts.

77. Call money rates had risen sharply in November 1995 to touch a level of 85 per cent by November 3, 1995 because of banks' asset liabilities maturities mismatches, the massive demand for non-food credit and the gradual withdrawal of Reserve Bank support to money market on account of its intervention in the forex market. On account of general pressure on the exchange rate of rupee in October 1995, the Reserve Bank had taken measures to stabilise the rupee by selling dollars which absorbed rupee resources from the money market. This in turn mounted pressure on the call money rates. With a view to moderate the volatile call money rates, the Reserve Bank extended its support to money market from a level of Rs.400 crore as on November 30, 1995 to a level of Rs.5500 crore by December 8, 1995. Apart from restoration of support to money market, the Reserve Bank reduced the CRR from 15 per cent to 14 per cent and exempted the incremental FCNR (B) deposits over the level of November 24, 1995 from CRR. These measures together augmented the resources of banks by Rs.5050 crore. As a result of a series of measures undertaken by the Reserve Bank, call money rates came down to a level of below 20 per cent by November 30, 1995. During the fortnight ended January 5, 1996 the call money rates again firmed up on account of advance tax payments and the general apprehension of a pressure on interest rates. As a result, the call money rates touched the level of 35-40 per cent. The Reserve Bank again resorted to market support through the DFHI and STCI. The level of market support was to the extent of Rs.2730 crore on January 1, 1996. In order to augment the resources of banks further, the FCNR (B) and NRNR deposits have been exempted from the maintenance of CRR and the CRR on NRE deposits has been reduced from 14 per cent to 10 per cent effective January 6, 1996. These measures together augmented the banks' resources by Rs.2475 crore. As a result of intervention in the money market and the general relaxation in reserve requirements, call money rates have come down to a level of 10 per cent to 11.5 per cent by January 16, 1996.

## Outlook

78. Regulatory reform is a dynamic process given the pace of financial evolution world-wide. Besides autonomy and independence of SEBI, two other critical elements are the building up of human resources and expertise in the system, and putting in place consultative mechanisms which can bring in a wide array of information and knowledge from the financial community into the regulatory system.

79. Regulatory reforms have already launched the process of changing our equity markets to better serve the needs of both investors and fund raisers. In the next few years, the system will be completely transformed by the setting up of depositories and clearing and settlement corporations. The challenge will be to balance the efficiency, and cost and risk reducing benefits of an integrated uniform system, against the imperatives of regional diversity, decentralised operation and the interests of local stock exchanges. This balance will determine, not only the size and growth of a national equity market, but also the role that the Indian capital market can play in the international financial system.

80. A key step in the development of capital markets is the debt market. An important element of this is a much wider and deeper government securities market. The development of this long term debt market will partly determine how quickly the commercially viable infrastructural developments can take place. This involves a greater appreciation of various aspects of the debt market across a diverse group of agencies and departments.