

## Primary Market Reforms

6. Keeping in view the need to develop the primary market as an efficient vehicle for mobilisation of resources, SEBI took a number of measures designed to boost investor confidence. New measures were introduced by SEBI after a series of formal and informal consultations with the market participants, Associations of Merchant Bankers of India and the Advisory Committee on Primary Market. These seek to further simplify the issue procedure to facilitate both resource mobilisation and investor protection. (Box 4.1)

7. Issuers proposing to make the first offer of equity to the public, including any security convertible into equity, have been allowed to do so if they have a track record of dividend payment in the immediately preceding three years. Listed companies are not bound by entry norms if their

post-issue net worth does not exceed five times their pre-issue net worth. Unlisted companies have been allowed to freely price their securities provided they have shown net profit in the immediately preceding three years. These measures are expected to boost industrial investment in the economy.

8. To enable banks, including those in the private sector, to access the capital market, relaxations were made in regard to both entry norms and share pricing. Banking companies which had received approval or license from RBI on or before April 16, 1996 and the public sector banks were exempted from entry norms. Since public sector banks are regulated by the RBI, they were allowed to freely price their issues on the basis of profitability for two years as against three years for others. The norms for entry and free pricing

### BOX 4.1

#### Primary Markets Reforms 1997-98

- Entry barrier for unlisted companies modified as dividend payment in immediately preceding 3 years.
- A listed company required to meet the entry norm only if the post-issue net worth becomes more than five times the pre-issue net worth.
- Companies required to make their partly paid-up shares fully paid up or forfeit the same, before making a public/rights issue.
- Unlisted company allowed to freely price its securities provided it has shown net profit in the immediately preceding 3 years subject to its fulfilling the existing disclosure requirements.
- The Promoters' contribution for public issues made uniform at 20% irrespective of the issue size.
- Written consent from share holders in regard to lock-in made compulsory for securities to be offered for promoter's contribution.
- Appointment of Registrar to an issue for rights issues made mandatory.
- A provision made regarding disclosure of the share holding of the promoters whose names figure in the paragraph on "Promoters and their background" in the offer document.
- The SEBI (Registrars to an Issue and Share Transfer Agents) Rules and Regulations 1993 have been amended to provide for an arm's length relationship between the Issuer and the Registrar to the Issue. It has now been stipulated that no Registrar to an Issue can act as such for any issue of securities made by any body corporate, if the Registrar to the issue and the Issuer company are associates.
- With a view to facilitating raising of funds by infrastructure projects, SEBI has allowed debt instruments to be listed on the Stock Exchanges without prior listing of equity. Corporates with infrastructure projects and Municipal Corporations to be exempted from the requirements of Rule 19(2b) of Securities (Contract) Regulation Rules to facilitate public offer and listing of its pure debt instruments as well as debt instruments fully or partly convertible into equity without the requirement of prior listing of equity but subject to conditions like investment grade rating.
- Only body corporates to be allowed to function as Merchant Bankers.
- Multiple categories of merchant bankers to be abolished and there shall be only one entity viz., Merchant Banker. Presently, the Merchant Banker allowed to perform underwriting activity but required to seek separate registration to function as a Portfolio Manager under the SEBI (Portfolio Manager) Rules and Regulations, 1993.
- Merchant Bankers to be prohibited from carrying on fund based activities other than those related exclusively to the capital market; the activities undertaken by NBFCs such as accepting deposits, leasing, bill discounting, etc. not to be allowed to be undertaken by a merchant banker; the existing NBFCs performing merchant banking activities to be given suitable time to restructure their activities.

are not applicable to the private sector and local area banks, which have been granted license by the Reserve Bank. These measures seek to facilitate recapitalisation of commercial banks, which can no longer obtain concessional resource support from the Government/Reserve Bank.

9. To facilitate the financing of infrastructure projects, infrastructure companies and municipal corporations were exempted from the requirement of listing equity first any debt instrument could be listed on the stock exchanges. As debt instruments assume considerable significance in the mobilization of savings for financing infrastructure projects which have long gestation period, this facility would help infrastructure companies and municipal corporations to raise funds through public issuance of investment grade rated debt instruments.

10. Participation of small investors is vital for the success of public issues. With effect from July 29, 1997 an option has therefore been provided to issuers/offers to fix maximum marketable lot on the basis of offer price, subject to the condition that the maximum tradable lot shall not exceed 100 shares.

11. As part of the simplification and streamlining of issue procedures, the system of vetting of offer documents by SEBI prior to a public offer was discontinued. In its place a system of filing of draft prospectus with SEBI prior to the public issue was introduced. The period of validity for SEBI's letter of observation on offer documents was

extended to 365 days from the existing period of three months.

12. To protect investors subscribing to bonds issued by plantation companies, government had decided that entities which issue instruments such as agro-bonds, plantation bonds etc. would be regulated by SEBI as collective investment schemes. A Committee has been appointed by SEBI under the chairmanship of Dr. S.A. Dave, former Chairman, Unit Trust of India to prepare regulations on the subject. Keeping in view the need to protect investors, SEBI has directed that no entities which issue instruments like agro bonds, plantation bonds, etc. under the existing schemes shall mobilise any money from the public or from the investors unless such instruments carry a rating from any of the recognised credit rating agencies.

13. The High Level Committee on Capital Markets headed by RBI Governor noted the steady decline in the amount of capital raised from the primary market, particularly in 1996-97 and 1997-98. The Committee also noted the substantial rise in the capital raised through the private placement route in the same period. In order to better understand the behaviour of the market and recommend steps to improve market conditions, an Informal Group was set up under the chairmanship of Dr. Shankar N. Acharya, Chief Economic Adviser, in the Ministry of Finance (Box 4.2).

#### **BOX 4.2**

##### **Major Recommendations by the Informal Group on Primary Market**

- Listing Requirements of stock exchanges to be made more stringent and stock exchanges should be made more accountable to create greater investor confidence.
- Creation of an effective institutional arrangement for protecting small investors.
- Better corporate governance on the part of industry; accounting norms to be made uniform and international standards to be adopted.
- Part of the public sector divestment being done through the GDR route could be done in the domestic market.
- Market making could be made compulsory at least for a period of six to twelve months after listing of issues.
- Adequate amount of credit to be made available to market makers.
- Derivating trading should be introduced quickly in order to provide hedge instruments for institutional players.
- Depository mode of transactions to be popularised; the possibility of new issues through the depository should be explored as a means of reducing cost of issue substantially.
- Entry norms for companies to access the market should be made more stringent.
- Greater accountability should be fixed on intermediaries for due diligence and disclosure norms.
- Private placements have a role; at the same time it should be ensured that public issues are not passed off as private placements. Private placements involving investors above a certain number should be subject to disclosure requirements; alternatively, private placements could be restricted to Qualified Institutional Investors (QIIs) or High Networth Individuals.

## Merchant Banking

14. Structural changes have been brought about in merchant banking activity. The multiple categories of merchant bankers have been abolished and replaced by a single category which can only carry out issue management activity. Segregation has been brought about between fee based and fund based activities and merchant bankers have been prohibited from carrying on any fund based activity such as acceptance of deposits, leasing and bill discounting. Arm's length relationship has also been introduced between an issuer and the registrar to issue.

### Resource Mobilisation from Primary Market

15. Lower flow of resources from Government in the form of budgetary support has induced the Public Sector enterprises to enter the market for investible funds while reduction in the concessional resource support by the RBI has forced the Financial Institutions and Banks to tap the capital market. The introduction of capital adequacy norms also enhanced the resource requirements of banks. However, the ability of the primary market to mobilise funds varied widely between 1995-96 and 1997-98. During this period the primary market witnessed a steep decline in resource mobilisation from a high of Rs. 20,804 crore raised through 1726 issues in 1995-96 to Rs. 4,570 crore through 111 issues in 1997-98.

16. As may be seen from Table 4.1, both the

number of issues and the amount raised registered a substantial decline in 1997-98. The amount mobilised declined from Rs.14,276 crore in 1996-97 to Rs. 4,570 crore in 1997-98. The number of issues fell steeply from 882 to 111 during the same period. The average size of issue, however, more than doubled in 1997-98. Although there was a decline in the number of issues, investors responded favourably and sometimes overwhelmingly to the issues. This signalled growing investor preference and awareness for quality of issues which have seen marked improvement, following the introduction of stringent entry point norms by SEBI.

17. The Report of the Committee on regulatory framework for Derivatives Trading in India chaired by Dr. L.C. Gupta was considered by SEBI. The recommendations accepted by the regulatory authority include phased introduction of derivative products with stock index futures as the starting point for equity derivatives in India, and expanded definition of "Securities" under the Securities Contracts (Regulation) Act (Box 4.3). It was also decided by SEBI that the Mutual Funds should make necessary disclosures in their offer documents if they opt to trade derivatives. For the existing schemes they would require the approval of their unit holders. The SEBI also approved the suggestive Bye-Laws proposed by the Committee covering the operational aspects for regulation and control of trading and settlement of derivative contracts.

Types of Issues	1995-96		1996-97		1997-98	
	No	Amount	No	Amount	No	Amount
Rights	298	6564.12	131	2719.20	49	1708.01
Public	1428	14239.53	751	11556.78	62	2861.94
Total	1726	20803.65	882	14275.98	111	4569.95

### BOX 4.3

#### Accepted Recommendations made by the LC Gupta Committee on Derivatives

- There should be phased introduction of derivative products with the stock index futures as the starting point for equity derivatives in India.
- Definition of "Securities" under Securities Contracts (Regulations) Act be expanded by declaring derivative contracts based on index of prices of securities and other derivative contracts as securities.
- Existing Stock Exchanges be permitted to trade derivatives provided they meet the eligibility conditions which would, inter-alia, include adequate infrastructural facilities, online trading and surveillance system and minimum of 50 members opting for derivative trading.
- The derivative market should have a separate Governing Council with representation of trading/clearing members of the derivative segment limited to 40%. The Chairman of the Governing Council shall not carry on any trading or clearing business on any Exchange during his tenure as Chairman. Further, no trading/clearing member shall be allowed to simultaneously be on the Governing Council of derivative segment and the underlying securities market.
- Initial margin requirements related to the risk of loss on the position and capital adequacy norms shall be prescribed.
- Annual inspection of all the members operating in the derivative segment would be undertaken by the Stock Exchanges.
- The Exchanges would disseminate information about trades, quantities and quotes in real time over at least two information vending networks.
- The clearing corporations/house to settle derivative trades would have to meet certain specified eligibility conditions and the clearing corporation/house must interpose itself between both legs of every trade, becoming the legal counter party to both or alternatively provide an unconditional guarantee for settlement of all trades.
- There would be two tier membership i.e. the trading member and clearing member and the entry norms for the clearing member would be comparatively more stringent. The clearing member should have a minimum net worth of Rs. 3 crore and shall make a deposit of Rs.50 lakh with the Exchange/clearing corporation in the form of liquid assets.
- A model Risk Disclosure Document would be prescribed and the Exchange would monitor the broker dealer/client relationship. The sales personnel working in the broker dealer office would need to pass a certification programme.
- Corporate clients/financial institutions/Mutual Funds should be allowed to trade derivatives only if and to the extent authorised by their Board of Directors/Trustees.
- The issue of accounting and disclosure norms for derivatives be taken up with the Institute of Chartered Accountants of India so that proper accounting and disclosures are made in the annual reports of the corporates and others.