3 Primary Market

The primary market, which really chanellises savings of investors to productive uses, reflects inter play of the forces that affect the sentiments and confidence the corporate sector as well as of investors in the new issues of capital. The market remained subdued during 1995-98 due depressed conditions in secondary market, prevailing high real interest rates and stringent entry norms. This was fuelled by low confidence of investors arising from unduly high premium charged on issues made in earlier years and disappearance of some of these issuers. The declining sentiments in the market seems to be have at least been arrested during 1998-99 thanks to Banks/FIs who accessed market and mobilised 85% of resources raised during the year. The market seems to be looking up during April-December 1999 with a spate of issues by IT companies.

POLICIES AND PROGRAMMES

Various measures initiated by Government and regulators seem to have contributed to improvement of sentiments in the market. Measures initiated during the year 1998-99 include:

Revision of entry norms for Initial Public Offer

SEBI norms permit a new company to come out with an IPO if it has a dividend payment track record for 3 out of immediately preceding 5 years. In order to encourage IPOs, SEBI relaxed this requirement of the 'actual payment of dividend' to 'ability to pay dividend' in terms of Section 205 of the Companies Act, 1956. That is, the company making IPO must have distributable profits for at least three out of immediately proceeding five years. It was made necessary for the company making an IPO to be able to pay dividend to have a minimum pre-issue networth (i.e. paid up capital and free reserves minus intangible assets and revaluation reserves) of not less than Rs. 1 crore in three out of the preceding five years, with a minimum networth to be met during the immediately preceding two years.

The banks were exempted from fulfilling eligibility norms for making public issues. They can make equity issues at a price approved by RBI.

The requirement of 30 mandatory collection centres was reduced with a view to minimise the cost of the public issues. The minimum number of collection centres for an issue of capital would now be:

a. the four metropolitan centres and

b. such centres where the stock exchanges are located in the region in which the registered office of the company is situated

Relaxation of entry norms for infrastructure companies

With a view channelise greater flow of funds to infrastructure companies, SEBI granted a number of relaxations to infrastructure companies. These included:

- Exemption from the requirement of making a minimum public offer of 25 percent of securities and also from the requirement of 5 shareholders per Rs. 1 lakh of offer made.
- Exemption from the minimum subscription of 90 per cent provided disclosure is made about the alternate source of funding considered by the company, in the event of under-subscription in the public issue.

- Permission to freely price the offerings in the domestic market provided the promoter companies along with equipment suppliers and other strategic investors subscribe to 50 percent of the equity at the same price as the price offered to the public or at a price higher than that offered to the public.
- Permission to keep the issues open for 21 days to enable the companies to mobilise funds.
- Exemption from requirement to create and maintain a debenture redemption reserve in case of debenture issues as provided in the SEBI Disclosure & Investor Protection Guidelines

These concessions are available to them if these are appraised by a Development Financial Institution, Infrastructure Development Finance Corporation or Infrastructure Leasing and Financing Services Ltd. and there is a minimum financial participation by them. The minimum participation of the appraising agency, initially fixed at 10% of project cost, was reduced to 5%. Further, the minimum participation can be met by any of the appraising agencies, jointly or severally, irrespective of whether they appraise the project or not.

Employee Stock Option/Employee Stock Purchase Plans

SEBI had constituted a Committee under the Chairmanship of Prof. J.R. Varma, member of SEBI, to formulate the guidelines for Employee Stock Option Plan (ESOPs)/Employee Stock Purchase Plans (ESPPs). The recommendations of the Committee were accepted by SEBI. The salient decisions in this regard are :

ESOPs

Issue of stock options at a discount to the market price would be regarded as another form of employee compensation and would be treated as such in the financial statements of the company regardless of the quantum of discount on the exercise price of the option. ESOPs would not be covered by the pricing provisions of SEBI's preferential allotment guidelines. The issue of ESOPs would be subject to approval by shareholders through a special resolution. There would be no restriction on the maximum number of shares to be issued to a single employee. However in case of employees being offered more than 1% of shares, a specific disclosure and approval would be necessary in the AGM. A minimum period of one year between grant of options and its vesting is required. After one year, the period during which the option can be exercised would be determined by the company. The operation of ESOP would have to be under the superintendence and direction of a Compensation Committee of the Board of Directors in which there would be a majority of independent directors. ESOP would be open to all permanent employees (whether working in India or abroad) and to the directors of the company but not to promoters and large shareholders. With specific approval of the shareholders, the scheme would be allowed to cover the employees of a subsidiary or a holding company. The disclosures required to be made in the Director's Report or in the annexure to the Director's Report regardless of whether the stock options are issued at a discount or not are: the total number of shares covered by the ESOP as approved by the shareholders, the pricing formula, options granted, options vested, options exercised, options forfeited, extinguishment or modification of options, money realized by exercise of options, total number of options in force, employee wise details of options granted to senior managerial personnel and to any other employee who receives a grant in any one year of options amounting to 5% or more of options granted during that year, fully diluted Earnings Per Share computed in accordance with international accounting standards.

ESPPs

In respect of shares issued under an ESPP scheme during any accounting period, the accounting value of the shares so issued shall be treated as another form of employee compensation in the financial statements of the company. ESPPs would not be covered by the pricing provisions of the SEBI's preferential allotment guidelines. Shares issued under an ESPP shall be locked in for a period of one year. However, if the ESPP is a part of a public issue and the shares are issued to employees at the same price as in the public issue, the shares shall not be subject to any lock-in.

The companies would continue to have the alternative of issuing shares to employees in full compliance with the SEBI guidelines on preferential allotment without subjecting themselves to the ESOP/ESPP guidelines

The measures initiated during April-December 1999 include :

Abolition of Standard denomination for Equity Shares

The Central Government had issued various circulars over the years with regard to standard denominations for corporate securities directing the companies to have uniform denomination of Rs.10 or Rs.100 for equity shares. With a view to give flexibility to companies to fix any denomination of its equity shares, these circulars were modified as under:

1. The companies shall have the freedom to issue shares in any denomination to be determined by them in accordance with section 13(4) of the Companies Act, 1956. While doing so, the companies will have to ensure that shares are not issued in denomination of less than one rupee or decimal of one rupee.
2. The companies which seek to change the standard denomination may do so after amending the Memorandum and Articles of Association, if required.
3. The existing companies, which have issued shares at Rs.10 and Rs.100, may also change the standard denomination into any denomination not below Re.1 by splitting or consolidating the existing shares after amending their Memorandum and Articles of Association. At any given time there shall be only one denomination for the shares of a company.
4. Only those companies, whose shares are dematerialised, shall be eligible to alter the 'standard denomination'.
5. The Stock Exchanges may also make necessary changes in their existing trading and settlement software to give effect to this decision.
6. With a view to enable the investors to take informed investment decision, the stock exchanges are also directed to reflect the denomination value of the shares as fixed by the company along with the market quotations.
7. The companies desirous to avail of the facility would be required to adhere to disclosure and accounting norms as may be specified from time to time.

This measure would give freedom to companies to price their IPOs below Rs.10 and would thus be an extension of free pricing. This will also harmonize the existing separate disclosure and entry point norms for par and premium issues.

Guidelines for Issues to be made through 100% Book Building Route

SEBI had issued guidelines in October 1997 for book building which were applicable for 100% of the issue size and for issues above Rs. 100 crore. The guidelines were revised subsequently to reduce the limit to issues of Rs. 25 crore to encourage the use of this facility. However, no issuer used this facility. SEBI modified the framework for book building further in October 1999 to make it more attractive. The modified framework does not replace the existing guidelines. The issuer would have option to issue securities using book building facility under the existing framework or the modified set up broadly as given below :

1. The present requirement of graphical display of demand at bidding terminals to syndicate members as well as the investors has been made optional.
2. The 15% reservation for individual investors bidding for up to 10 marketable lots may be merged with the 10% fixed price offer.
3. Allotment for the book built portions shall be made in damat form only.
4. The issuer may be allowed to disclose either the issue size or the number of securities to be offered to the public.
5. Additional disclosure with respect to the scheme for making up the deficit in the sources of financing and the pattern of deployment of excess funds shall be made in the offer document.

Eligibility norms for public issues/offers for sale by companies in the IT Sector

Eligibility norms were modified to provide that a company in the IT Sector going for IPO/offer for sale shall have track record of distributable profits as per Section 205 of the Companies Act in three out of five years in the IT business/from out of IT activities. It can also access the market through the alternative route of appraisal and financing by a bank or financial institution. The same conditions would apply also to a listed company which has changed its name to reflect activities in IT sector.

Marketing initial public offers (IPOs) through the secondary market

SEBI approved a proposal of marketing IPOs through the secondary market. It proposes to use the existing infrastructure of stock exchanges (terminals, brokers and systems), presently being used for secondary market transactions, for marketing IPOs with a view to get rid of certain inherent disadvantages faced by issuers and investors like tremendous load on banking and postal system and huge costs in terms of money and time associated with the issue process. This system would confirm to all extant statutory requirements. The investor would approach broker for placing an order for buying shares of primary issues. The registrar in consultation with merchant banker and the regional stock exchange of the issuer will finalise the basis of allotment and intimate the same to the exchanges who in turn shall inform the brokers. The brokers will advise the successful allottees to submit the application form and the amount payable towards the shares. The broker will deposit the amount received in a separate escrow account for the primary market issue. The clearing house of the exchange will debit the primary issue account of the broker and credit the issuer's account. Subsequently, the certificates would be delivered to the investors or the depository account of the investor would be credited. The securities can be listed on the stock exchange from the 15th day from the closure of the issue as against 45-60 days at present. As investors will have to part with their funds only on successful allotment, their funds are not unnecessarily blocked. This would also ensure that refunds are done away with. The system seeks to reduce the time taken presently for completion of the issue process, as well as the cost of the issue.

MARKET TRENDS

According to SEBI data, the year 1998-99 witnessed 111 issues which collectively raised an amount of Rs. 5586 crore as against 58 issues with an amount of Rs. 4570 crore during the preceding year. This trend continued during April-December 1999 when a total of Rs. 5723 crore was raised through 60 issues, as may be seen from Table No.1. The year 1997-98 had recorded a decline of 68% in the resources mobilised in comparison to previous year while 1998-99 and April-December 1999 recorded a growth of 22% and 46% respectively over the corresponding period of previous year. Public issues contributed 90% and 76% of total resources raised during 1998-99 and April-December 1999 respectively. This indicates that the companies are making large sized issues and increasingly relying on public issues rather than on existing shareholders.

As stated earlier, companies seem to be preferring mega issues. The year 1998-99 witnessed 11 mega issues accounting for 83% of resources raised against 12 issues accounting for 75% in the preceding year. The 14 mega issues that were made during April-December 1999 accounted for 79% of resources raised during the period. Most of the mega issues are being made by Banks/FIs. The average size of the issues (including public and rights) during April-December 1999 works out Rs. 95.4 crore as against Rs 96.32 crore during 1998-99 and Rs.41.17 crore during 1997-98. There were 7 issues below Rs. 5 crore during April-November 1999 as against 15 and 52 issues during 1998-99 and 1997-98 respectively.

It is observed from Table No.2 that listed companies floated 40 issues and mobilised Rs. 5,182

Table No. 1: Resources Raised *(Amount in Rs. Crore)*

Issue	1997-98		1998-99		April - Dec 99	
	No.	Amount	No.	Amount	No.	Amount
Public	62	2862	32	5019	38	4339
Rights	49	1708	26	568	22	1383
Total	**111**	**4570**	**58**	**5586**	**60**	5723

Source: SEBI

Table No. 2: Distribution of issues: Type of Issuer *(Amount in Rs. Crore)*

	1997-98		1998-99		April - Dec 99	
	No.	Amount	No.	Amount	No.	Amount
Listed	59	3522.43	40	5182.25	32	3896
IPOs	52	1047.52	18	404.21	28	1827
Total	**111**	**4569.95**	**58**	**5586.46**	**60**	**5733**

Source: SEBI

accounting for 93% of the resources, while there were only 18 IPOs mobilising Rs. 404 during 1998-99. The previous year had witnessed 59 issues by listed companies for Rs. 3522.43 crore, when the share of IPOs in resource mobilisation was 30%. However the share of IPOs in resource mobilisation has improved to 32% during April-December 1999. This indicates increasing participation by new companies.

Most of the resources raised are mobilised by private sector which made 55 issues and raised 98 percent of the total resources during 1998-99 as against 84% during 1997-98. The share of private sector in resources mobilised remained steady at 96% during April-December 1999. The private sector raised Rs. 5,509 crore during April-December 1999 compared to Rs. 5,483 crore and Rs. 3,821 crore during 1998-99 and 1997-98 respectively, as may be seen from Table No. 3.

According to data available from Prime Database as presented in Table No. 4, 78% of the public issues failed to elicit adequate response (<1.5 times), while only 6% of the issues were subscribed over ten times in 1998-99. The most subscribed issue during 1998-99 was the issue by KPIT systems which was over subscribed by 42 times. There is, however, a clear trend, as may be seen from Table No. 4, that public response is improving in the recent past.

Table No. 3: Sector-wise Distribution of Resources Raised *(Amount in Rs. Crore)*

Sector	1997-98		1998-99		April - Dec 99	
	No.	Amount	No.	Amount	No.	Amount
Private	102	3820.97	55	5483.14	57	5509
Joint	03	31.11	02	33.02	1	14
Public	06	717.87	01	70.30	2	200
Total	**111**	**4569.95**	**58**	**5586.46**	**60**	**5733**

Source: SEBI

Table No. 4: Response to Public Issues offered to Indian Public *(% of Issues)*

Times subscribed	1998-99	1997-98	1996-97	1995-96	1994-95	1993-94
< 1.5	78	86	91	62	23	56
1.5 – 3	13	10	6	18	15	17
3 – 10	3	3	2	12	30	16
> 10	6	2	1	8	32	12

Source: Prime Annual Report

Table No. 5: Resource Mobilised through Debt and Equity

Year	Share (%) of	
	Equity	Debt
1994-95	70.58	29.42
1995-96	72.39	27.61
1996-97	55.99	44.01
1997-98	41.17	58.83
1998-99	15.34	84.66
April-Dec 1999	38.81	61.19

Source: SEBI

The equity had been the preferred means of raising resources by the companies. However, during the 1980s and early 1990s and in the recent past, the debentures dominated the scene. The debt raisings increased from 29% in 1994-95 to 85% in 1998-99, but reduced to 61% in April-December 1999. With market looking up, the preference of investors is shifting towards equity.

The banks and financial institutions garnered 85% of the total amount raised during 1998-99 as against 49% during the preceding year. The cement and construction industry had a share of 3.6% only during 1998-99. While almost all the industry groups had presence in the market during previous years, 1998-99 was dominated by Banks/FIs. This indicates increasing intermediation. Though the financial sector still dominates, its share reduced during April-December 1999 which witnessed 12 issues by Banks/FIs accounting for 53% of total resources mobilised. Sizable amount was also raised by IT sector which made 20 issues and raised 24% of resources. Industry-wise distribution of resources raised is presented in Table No. 6.

Book Building Through On line IPO System

In its strive to continuously improve Indian securities market NSE offers its infrastructure for conducting online IPOs through book building. The advantages of this new system are : a) the investor parts with money only after allotment, b) it eliminates refunds except incase of direct applications and c) it reduces the time taken for

Table No. 6: Industry-wise Distribution of Resources Raised

Industry	Percentage Share			
	1996-97	1997-98	1998-99	April-Dec 1999
Banking/FIs	40.29	49.06	84.81	53.10
Cement & Const.	5.47	0.49	3.56	5.89
Chemical	5.41	4.96	0.65	3.17
Electronic	0.91	1.36	3.65	3.72
Engineering	2.08	2.36	0.48	0.10
Finance	9.76	1.61	1.35	0.57
Food Processing	3.21	1.87	0.38	0.82
Health Care	2.21	0.60	0.00	1.33
Info. Tech.	0.55	0.19	0.84	24.34
Metal	6.78	17.82	0.06	0.00
Mining	0.53	2.35	0.37	0.00
Misc.	8.22	6.03	0.48	4.31
Packaging	0.49	0.11	0.00	0.00
Paper & Pulp	0.71	0.35	0.00	0.25
Plastic	0.49	0.26	0.00	0.12
Power	0.00	0.00	0.23	0.26
Telecommn.	0.27	0.11	0.00	1.31
Textile	5.41	9.15	2.18	0.73
Tourism	0.69	0.61	0.00	0.00
Transport	6.52	0.71	0.96	0.00
Total	**100.00**	**100.00**	**100.00**	**100.00**

Source: SEBI

issue process. The securities can get listed on the exchange from the 15th day from the closure of the issue as against 45-00 days in case of normal issues. NSE's on-line IPO system was launched with the book building issue of *Hughes Software Systems Ltd.* in September 1999. The book was oversubscribed by nearly 26 times.

HCL Technologies Ltd. (HTL) was the next issue handled by the Exchange. 189 trading members members having 535 users across the country participated in the book building Issue of HTL. Book was open between November 16, 1999 to November 24, 1999. Book built portion was for 1,27,80,000 equity shares of Rs.4 each. Bidding price range for the issue was from Rs.4 to Rs. 870. HTL had planned to raise Rs.741.24 crore from the IPO through book building. Instead, the company received a total subscription for 33,54,80,750 shares worth Rs. 20,100 crore which is 27 times the offer size. Issue price for the fixed price portion was fixed at Rs. 580 per share.

MUTUAL FUNDS

The small investors who generally lack expertise to invest on their own in the securities market have reinforced the saying "*Put not your trust in money, put your money in trust*". They prefer some kind of collective investment schemes like mutual funds (MFs), which pool their marginal resources, invest in securities and distribute the returns therefrom among them on co-operative principles. The investors benefit in terms of reduced risk and higher returns arising from professional expertise of fund managers employed by the MFs. This approach was conceived in the USA in the 1930s. In developed financial markets, MFs have almost overtaken bank deposits and total assets of insurance funds. At the end of March 1998, there were over 7011 open ended MFs in the US with total assets of over US $ 5 trillion.

India's experiment with MFs started in 1964 with the establishment of the Unit Trust of India (UTI) which continues to be market leader even today with about a corpus of investible funds of about Rs. 53320 crore at the end of March 1999, accounting for 78% of total market. However, UTI lost its monopoly status with the entry of non-UTI public sector MFs promoted by public sector banks and insurance companies in 1987. The industry was opened to private sector including foreign institutions in 1993 giving the Indian investors a broader choice and increasing competition to public sector funds. From one player till 1987, the number increased to 8 in 1993 and to 34 now. Starting with an asset base of Rs. 25 crore in 1964, the industry has grown at a compound growth rate of 27% to its current size of nearly Rs. 1,00,000 crore. At the end of December 1999, there were 34 funds in India with an asset base of about Rs. 97028 crore, offering a range of over 300 schemes.

The MFs in India offer a wide array of schemes that cater to different needs suitable to any age, financial position, risk tolerance and return expectations. These include Open-ended Schemes which provide easy liquidity, Close-ended Schemes with a stipulated maturity period, *Growth Schemes which* provide capital appreciation over the medium to long term, Income Schemes which provide regular and steady income to investors, *Balanced Schemes which* provide both growth and income by periodically distributing a part of the income and capital gains they earn, *Money Market Schemes which provide* easy liquidity, preservation of capital and moderate income and Tax Saving Schemes which offer tax rebates to the investors under tax laws as prescribed from time to time.

Policies and Programmes

1998-99

I. Standard disclosure document and abridged offer document were introduced to strengthen standards in MFs industry enabling investors to take informed decisions. It was made mandatory for each application form to be accompanied by an abridged offer document.

II. SEBI directed MFs to honour their commitment to investors in assured return schemes. The funds like Canbank Mutual Fund, GIC Mutual Fund, LIC Mutual Fund etc. collectively paid Rs. 1300 crore to investors by March 1999.

III. A limited cheque writing facility was introduced. This allows unit holders of MFs to issue cheques against saving bank account with a Bank.

IV. The SEBI (Mutual Fund) Regulations were amended to allow MFs to trade in derivatives of securities.

V. MFs were allowed to participate in securities lending subject to certain disclosures and reporting requirements.

1999-2000

I. The Budget for the year 1999-2000 granted the following tax sops :

i) All income from UTI and other MFs received in the hands of the investor are exempted from tax. In addition to reducing incidence of tax, it is expected to eliminate the inconvenience faced by small investors in paying tax and claiming refund in respect of such incomes.

ii) Dividends of open-ended equity schemes including US-64 with more than 50% investment in equities are exempted of dividend tax for three years

II. Recommendations of **P. K. Kaul Committee**

SEBI had constituted a Committee under the Chairmanship of Shri P.K. Kaul, former Cabinet Secretary, to recommend the manner of discharging responsibilities by the trustees as envisaged in the Regulations. Based on the recommendations of the Committee as well as feedback received from public and AMFI, SEBI took the following decisions on 17th August 1999:

a. Each trustee shall file the details of his transactions of buy or sell of securities with the trust on a quarterly basis.

b. All information and documents relating to the compliance process shall be authenticated / adopted by the Board of Directors of the AMC who are entrusted with the primary responsibility in this regard. In like manner, the Board of Directors of the Trustee Company would review all information and documents to be received from the AMC as required under the compliance process.

c. The manner in which due diligence shall be carried out by the Trustees in fulfillment of the various obligations as required under the Regulations, has been specified.

d. Uniform Management Information System shall be adopted and the compliance certificate to be submitted by the AMC to the trustees on periodical basis would contain specific comments. Further, the Board of Trustees or the Trustee Company, as the case may be, shall send reports to SEBI in the prescribed format.

e. The independent directors of the trustees / AMC shall pay specific attention to certain aspects, e.g. Compensation paid under Investment Management Agreement, Service Contracts with affiliates, Selection of the company's independent directors, etc.

f. With regard to the frequency of the meetings of the trustees / board of directors of the trustee company, there would be at least one meeting every three months and four such meetings to be held in a year. The Trust Deed shall also specify the quorum for such meetings provided that the quorum shall also specify the presence of at least one independent trustee / director.

g. The minimum number of trustees shall be four and it would be upto the mutual fund to decide the maximum number of trustees.

h. It shall be left to the discretion of mutual fund whether to appoint independent auditors or to have separate full fledged administrative set up to give support to the trustees in discharging their duties in accordance with SEBI Regulations.

i. The trustees shall not be held liable for acts done in good faith and if they have exercised adequate due diligence honestly.

III. SEBI approved the following amendments to the Mutual Fund Regulations on October 8, 1999:

i. Investment restrictions in equity related instruments

Investments in the equity shares or equity related instruments of a single company is restricted to 10% of the NAV of the scheme. However, this limit shall not be applicable in case of index funds and in case of sector/ industry specific schemes subject to adequate disclosures in the offer documents.

ii. Investment restrictions in rated and unrated debt securities

Investments in rated investment grade debt instruments issued by a single issuer is restricted to 15% of NAV of the scheme. This limit may be extended to 20% with the prior approval of the Board of AMC and Board of Trustees.

In case of unrated as well as rated but below investment grade debt instruments, the investment in a single issuer shall not exceed 10% of the NAV of the scheme and in case of such debt instruments of all the issuers in a scheme shall not exceed 25% of NAV subject to approval of Boards of AMC and trustee company.

However, these restrictions shall not apply to government securities and money market instruments.

iii. Investment in unlisted shares

Investment in unlisted shares is restricted to a maximum of 10% of the NAV of the scheme in case of close ended scheme and to 5% in case of open-ended schemes as there is continuous repurchase by investors in such a scheme.

iv. Investment restrictions in listed group companies

A mutual fund shall not invest more than 25% of NAV of any of its schemes in the listed securities of group companies of the sponsor instead of the present requirement of 25% of NAV of all the schemes put together.

v. Change in Control/Fundamental Attributes in

Case of an Open Ended Scheme

In case of change in control and fundamental attributes of open ended schemes, the unitholders shall be informed by way of individual communication and through advertisements in the newspapers and the unitholders shall be given option to exit at the prevailing NAV without any exit load. However, no such change shall be allowed for a period of one year from the date of allotment of units.

vi. Transactions with Associates

The MFs shall disclose at the time of declaring half-yearly and yearly results: (i) any underwriting obligations undertaken by the schemes of the MFs with respect to issue of associate companies, (ii) devolvement, if any, (iii) subscription by the schemes in the issues lead managed by associate companies (iv) subscription to any issue of equity or debt on private placement basis where the sponsor or its associate companies have acted as arranger/manager.

vii. Advertisement Code

Any advertisement on performance should be supported by relevant figures and such figures of NAV, yields or returns should be given for the past three years wherever applicable. Advertisements reproducing selective extracts from the offer document which could be misleading should not be published. Celebrities should not be displayed in advertisements.

viii. Code of Conduct

Code of conduct shall include certain clauses pertaining to integrity, due diligence, fairness in dealings etc which should be adhered to by the AMC and the Trustees.

ix. Portfolio Management Activities

AMCs allowed to carry out portfolio management activities subject to certain conditions.

x. Net Worth Requirement in case of an AMC :

The definition of the Networth will be elaborated for the sake of clarity and uniformity.

Resource Mobilisation

Popularity of the MFs as an investment vehicle may be seen in Table No.7 The schemes of MFs of the commercial banks and the insurance companies, which entered the market in 1987, were well received and resource mobilisation doubled every year during during 1987-89. This was further fuelled by the assured returns schemes offered by a few MFs, which created a perception that MFs were as safe as bank deposits. The boom continued into the nineties with the liberalization evoking positive response from the investors. In 1992-93, the MFs mobilised a record Rs.13, 000 crore. The resource mobilisations by MFs remained steady with annual gross mobilisation averaging Rs.11,000 crore per annum during the period 1993-95. However the crash in the financial markets in October 1994 and the continued prevalence of bearish conditions hit MFs severely. The years 1995-97 witnessed net outflows of resources from MFs. The market, however, picked up gradually thereafter.

The data available in respect of resource mobilisation by mutual funds are compiled by a number of agencies including the RBI, SEBI and Association of Mutual Funds in India (AMFI). The following analysis is, however, based on the AMFI data.

Table No. 7: Resource Mobilisation by MFs (In Rs. Crore)						
Year	Public Sector MFs				Private Sector MFs	Grand Total
	Bank sponsored	FI sponsored	UTI	Total		
1986-87	-	-	1261	-	-	1261
1987-88	250	-	2060	-	-	2310
1988-89	320	-	3855	-	-	4175
1989-90	888	315	5584	-	-	6787
1990-91	2352	604	4553	-	-	7508
1991-92	2140	427	8685	-	-	11253
1992-93	1204	760	11057	-	-	13021
1993-94	148	239	9297	-	1560	11243
1994-95	765	576	8611	-	1322	11275
1995-96	113	235	-6314	-	133	-5833
1996-97	6	137	-3043	-	864	-2037
1997-98	243	206	2875	-	678	4002
1998-99	253	576	170	-	2090	3090

Source : RBI Report on Currency and Finance, 1998-99

The year 1998-99 witnessed launch of 40 new schemes as against 43 during the preceding year. The resources were mobilised by mutual funds also through 192 and 237 old schemes during 1997-98 and 1998-99 respectively. The 40 new schemes together mobilised Rs. 9657 crore accounting for 45% of the total mobilisation during 1998-99 as against 43% during preceding year. MFs launched 35 new schemes during April-December 1999. They mobilized a gross amount of Rs. 33628 crore during the first nine months (April-December) of the current financial year 1999–2000 as against Rs. 18,701 crore and Rs. 21,377 crore during the financial years 1997-98 and 1998- 99 respectively. After adjustment of repurchases and redemptions, there was an inflow of funds of Rs. 3474 crore, Rs. 345 crore and Rs. 12027 crore during 1997-98, 1998-99 and April-December 1999 respectively.

Public sector MFs mobilised Rs. 13411 crore accounting for 72% of total mobilisation by the MFs during 1998-99 as against Rs. 14,026 crore with 75% during preceding year. The public sector raised Rs. 11540 crore during April-December 1999. UTI alone raised 74%, 62% and 29% of total resources mobilised during 1997-98, 1998-99 and April-December 1999 respectively. The net outflow of public sector was Rs.1237 crore during 1998-99 against a net positive inflow of Rs. 1582 crore by private sector mutual funds.

These funds were raised under close ended, open ended and assured schemes. The share of open ended schemes in total funds raised increased from 52% in 1997-98 to 67% in 1998-99 and further to 87% in April-December 1999. The share of assured return schemes in total funds raised decreased from 44% in 1997-98 to 26% in 1998-99 and further to 12% in April-December 1999. The share of close ended schemes remained almost unchanged at about 5% during 1997-99 but declined to less than 1% in April-December, 1999. The assured return schemes appear very promising in terms of net inflow of funds. During the year 1998-99, the open ended schemes and close ended schemes had outflows of Rs. 647 crore and Rs. 2604 crore, while the assured return schemes had an inflow of Rs. 3596 crore. The close ended schemes reported an outflow of Rs. 1617 crore while open ended schemes and the assured return schemes inflows of Rs. 9635 crore and Rs. 4018 crore during April-December 1999 respectively. Details of funds mobilised, repurchase/redemption by different MFs under different schemes in the recent past are presented in Table Nos. 8 and 9.

Assets under Management

There was a marginal increase in the assests under management during 1998-99. During first nine months of this year, the assests has increased by 42%. As may be seen from Table No. 8, the share of private sector MFs in total assets under management increased from 6% as on 31st March 1998 to 10% on 31st March 1999 and further to 20% on 31st December 1999. The UTI continues to be market leader with 78% share on 31st March 1999 and 69% on 31st December 1999. The shares of MFs in assets under management are presented in Figure No. 1.

As may be seen from Table No.10, the open ended schemes account for 59% of total assets under management of MFs at the end of December 1999. The close ended and assured return schemes account for about 20% and 21% assets under management of MFs respectively at the end of December 1999. The shares of different schemes in assets under management are presented in Figure No. 2.

As may be seen from Table No. 10, the income schemes account for 46.5% of total assets under

Table No. 8: Resource Mobilisation by MFs *(In Rs. Crore)*

	Category	1997-98		1998-99		1999-2000		Assets under management as on		
		Sale	Purchase	Sale	Purchase	Sale	Purchase	31.3.98	31.3.99	31.12.99
A	Unit Trust of India	13748	10080	11679	13364	9618	6176	57554	53320	67207
B	Bank Sponsored (6)	130	1120	420	772	1060	886	4872	5481	7290
C	Institutions (4)	148	383	1312	512	862	1242	2472	2811	2999
D	Private Sector	**4675**	**3644**	**7966**	**6384**	**22088**	**13297**	**4086**	**6860**	**19532**
I	Indian (6)	3032	2640	2739	2636	4247	3291	1031	1016	2225
II	Joint ventures – Predominately Indian (7)	1312	822	3019	2290	8019	4803	1583	3040	7977
III	Joint ventures – Predominately Foreign (10)	331	182	2208	1458	9822	5203	1472	2804	9330
	Grand total (A+B+C+D)	**18701**	**15227**	**21377**	**21032**	**33628**	**21601**	**68984**	**68472**	**97028**

Figures in brackets indicate number of mutual funds at the end of December 1999.
Source: AMFI Updates

Table No. 9: Resource Mobilisation by Schemes *(In Rs. Crore)*

	1997-98		1998-99		April - Dec 99	
	Sale	Purchase	Sale	Purchase	Sale	Purchase
Open end	9716	7629	14314	14961	29277	19642
Close end	752	7105	1490	4094	246	1863
Assured Return	8233	493	5573	1977	4114	96
Total	**18701**	**15227**	**21377**	**21032**	**33637**	**21601**

Table No. 10: Assets under Management as on 31st December 1999				*(In Rs. Crore)*
Scheme	**Open Ended**	**Close Ended**	**Assured Return**	**Total**
Income	17854	6695	20524	45073
Growth	11906	9719	-	21625
Balanced	22086	1244	-	23330
Liquid	2349	-		2349
Money Market	487	-	-	487
Gilt	1501	-	-	1501
ELSS	644	2019	-	2663
Total	**46827**	**19677**	**20524**	**97028**

Figure 1: Assets under Management at the end of December 1999

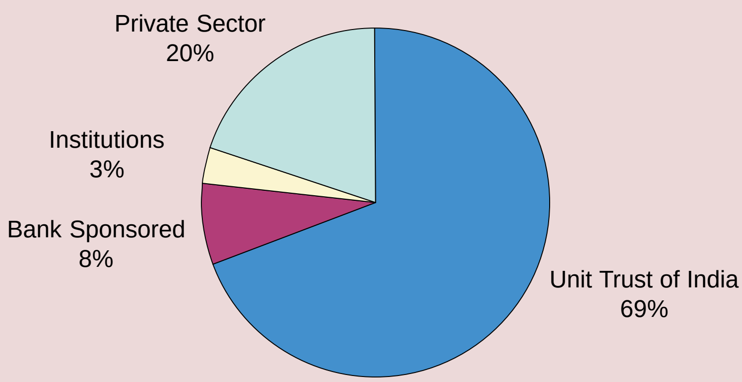


Figure 2: Assets under Management at the end of December 1999

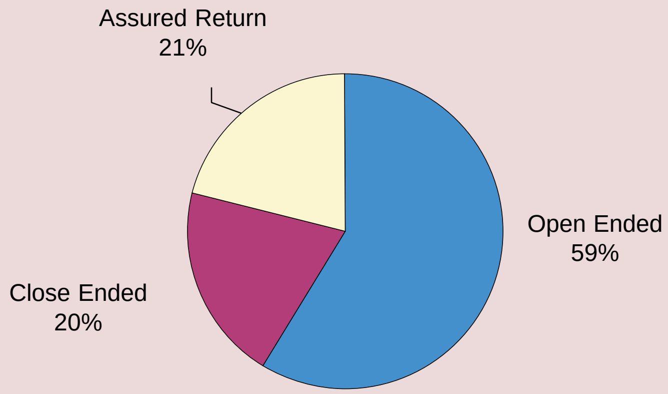


Figure 3: Assets under Management at the end of December 1999

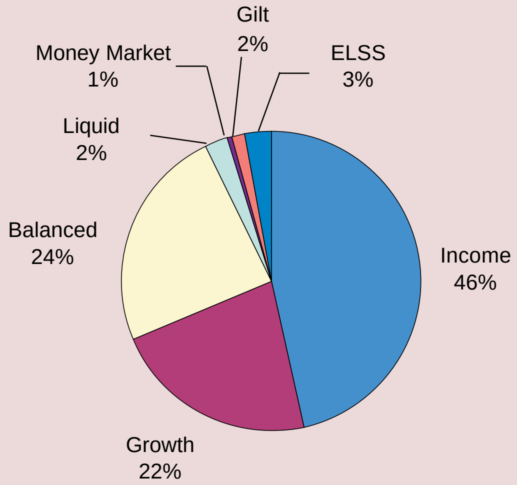
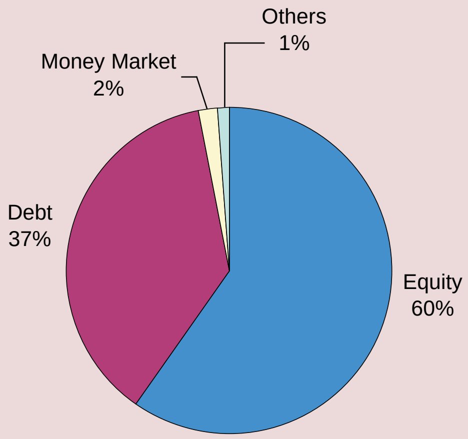


Figure 4: Investment of Assets at the end of March, 1999



management MFs at the end of December 1999, followed by balanced schemes with 24%. The growth schemes account for about 22% assets under management of MFs at the end of December 1999. The shares of different schemes in assets under management are presented in Figure No. 3.

About 58% of the assets were invested in equities at the end of March 1999. Asset wise classification of total assets under management is presented in Figure No. 4.

The year 1998-99 witnessed development of sectoral funds targeted for niche markets. Dedicated gilt-edge funds like Templeton India Government Securities Fund, Tata Gilt Fund were launched making the gilt market accessible to small investors. Funds for specific sectors like information technology (Kothari Infotech Funds), fast moving consumer durables (Prudential ICICI's Fast Moving Consumer Goods) were also launched during 1998-99. In addition to sector specific funds, MFs seem to be increasingly concentrating in a few high growth sectors. Their holdings concentrate in three sectors, namely, software, FMCG and pharmaceuticals. These three sectors account for more than 50% of total holdings by most of the MFs. Software dominates their holdings with majority of them making highest allocation for this sector.

Performance of MFs

During the year 1998-99, out of 26 open end equity funds, 21 outperformed and 5 under performed the Index. The returns from 15 funds that outperformed the index ranged from 26% to above 100%. Out of 33 open end equity funds, 25 outperformed and 8 under performed the Index. 44 out of 59 of the Equity Linked Savings Schemes outperformed and the balance 15 under performed the index, as may be seen from Table No. 11.

It is observed from Table No. 12 that growth and ELSS schemes generally outperformed the bench marks in terms of four yearly returns, while income and balanced schemes under performed. In terms of one yearly return, only income schemes outperformed the benchmark.

Unit Scheme 1964 (US 64)

The US 64 is the flagship scheme of the UTI. It has a corpus of about Rs. 20,000 crore subscribed to by about 21 million investors. Following a steep depreciation in its investments, UTI announced negative reserves of the scheme on 30th June 1998 creating a widespread concern, particularly among investors. In the light of perceived loss of investor confidence in the US 64, assurance by Government that it would support UTI and protect the interests of investors allayed fears of investors and prevented deepening of the crisis. UTI constituted a Committee Chaired by Mr. Deepak Parekh in October 1998 to undertake a comprehensive review of the functioning of the scheme and recommend measures for sustaining investor confidence and to strengthen the scheme. The terms of reference of the Committee were:

Table No. 11: Performance of Equity Funds - Summary Analysis for Year ended March 31, 1999

Sl. No.	Particulars	Open end	Close end	Equity Linked Savings Scheme
1	No. of Funds	26	33	59
2	No. of Funds Outperforming Index	21	25	44
3	Of which No. of Funds recording growth			
	1 - 25 per cent	6	13	23
	26 - 50 ”	6	3	10
	51 - 75 ”	4	5	3
	76 - 100 ”	4	-	3
	Above 100	1	-	2
4	No. of Funds recording decline of less than (-) 3.9%	-	4	3
5	No. of Funds Underperforming Index	5	8	15
6	Range of Decline	(-)4% to (-)23%	(-)6% to (-)25%	(-)6% to (-)27%

Based on data published in the Financial Express Dated April 10, 1999
Source : AMFI Update, April 1999

Table No. 12: Performance of MF Schemes						
4 Year Returns						
Investment Category	**Benchmark**	**Annualised Return**	**Category Average Returns**	**Total Scheme Options**	**Outperformers**	**Under-performers**
Growth schemes	Crisil 500	3.8%	11.0%	15	10	5
ELSS schemes	Crisil 500	3.8%	9.4%	23	14	9
Income schemes	AAA	15.4%	8.2%	20	0	20
Balanced schemes	50% Crisil + 50% AAA Debenture	9.7%	6.8%	10	1	9
1 Year Returns						
Investment Category	**Benchmark**	**Annualised Return**	**Category Average Returns**	**Total Scheme Options**	**Outperformers**	**Under-performers**
Growth schemes	Crisil 500	17.0%	12.1%	46	13	33
ELSS schemes	Crisil 500	17.0%	10.9%	50	11	39
Income schemes	AAA	14.5%	17.2%	48	28	20
Balanced schemes	50% Crisil + 50% AAA Debenture	15.7%	13.8%	18	8	10

Source: Crisil India. (Taken from AMFI's Web-site)

i. Review of the objectives, features and structure of the scheme in the context of its role in the mobilisdation of domestic savings and investment in the capital market.

ii. Review of the policies of the scheme relating to pricing and income distribution, having regard to profile of existing investors of the scheme, and

iii. Review of the policies and procedures about the portfolio composition of the scheme, as well as asset management process.

The Committee made, among others, the following recommendations in its report submitted in February 1999:

i. As a special dispensation, dividends from US 64 be rendered tax free in the hands of investors even if equity investments constitute less than 50% of total long term investments in the next three years while the scheme is being restructured.

ii. Commercial bank be encouraged to contribute Rs. 1000 crore to Rs. 1500 crore towards the corpus of a new equity related scheme to be promoted by the UTI.

iii. The UTI Act be amended to increase the size of Board of Trustees so as to induct five additional independent trustees.

iv. The UTI Act be amended to facilitate the setting up of an Asset Management Company. Pending the amendment, the present Asset Management Committee should be reconstituted and its role and responsibilities clearly defined.

v. Separate and independent team of fund managers for each scheme be appointed. The fund managers should have final authority and responsibility in the decision making process.

vi. Clear commitment from Government to stand by US 64 till it finally assumes the character of a NAV driven scheme will instill the required confidence in the US 64 investors.

vii. The concept of assured schemes, in an era of volatile interest rates, should be done away with in respect of all mutual fund schemes in the country.

viii. There will have to be a major re-allocation of the portfolio composition to provide for more weightage to debt consistent with the objectives of the scheme.

ix. The operations of the scheme be brought within the purview of the SEBI at the earliest.

Following the recommendations of the Committee, mid-course reorganisation and portfolio rebalancing was effected by UTI which by the end of the year led to positive reserve. A host of measures were also taken by Government. These include tax reliefs granted in the Budget for 1999-2000, as stated earlier. A swap arrangement was worked out whereby the Special Unit Scheme 99 (SUS 99) was created to which PSU stocks of US-64 were transferred on May 1, 1999. Government subscribed to SUS 99 through issue of dated GOI securities worth Rs. 3,300 crore. The GOI securities have a five year maturity with a coupon rate of 11.24%. SUS 99 discharged the transfer consideration of PSU stocks by transferring the dated GOI securities to US-64.

COLLECTIVE INVESTMENT SCHEMES

Policies and Programmes

It has been noticed in the recent past that many companies especially plantation companies have been taking investors for a ride by floating dubious schemes. This segment of the market presented a classic example of regulatory gap. The Department of Company Affairs did not take any action because such companies did not accept deposits under the Companies Act. RBI had no control as RBI Act was limited only to those entities whose principal business was of financial in nature. They did not come under the explicit purview of SEBI because they did not issue any securities. Exploiting these loopholes in the system, these companies thrived and got away with investors' money. Government intervention has recently put the onus on SEBI to regulate the schemes floated by plantation companies. The agro bonds/plantation schemes etc. are now treated as 'collective investment schemes' coming under provisions of section 11(2)C of the SEBI Act.

Securities Contracts (Regulation) Amendment Bill, 1998

The Securities Contracts (Regulation) Amendment Bill, 1998 was introduced in the Lok Sabha on 4th July 1998 proposing to expand the definition of "securities" to include within its ambit the units or any other instruments issued by any CIS to the investors in such schemes. This was aimed at an orderly development of market for these units while protecting the interest of investors therein. The Bill was referred to the Standing Committee on Finance on 10th July 1998 for examination and report thereon. The Committee submitted its report on 17th March 1999. The Committee held the opinion that there was a need to define CIS in the Act. They recommended that a definition of CIS suitably worded in consonance with the definition recommended by the Dave Committee set up by SEBI be included in the Act. The Bill, however, lapsed following the desolution of 12th Lok Sabha.

Regulations for Collective Investment Schemes

The SEBI Act prohibits any person from sponsoring or causing to be sponsored any CIS without obtaining a certificate of registration from SEBI in accordance with the regulations. Following Government decision, SEBI put a blanket ban on floating of such schemes till they frame regulations in this regard. The existing schemes were allowed to continue operations subject to certain compliances in terms of submission of information and credit rating. A committee under the Chairmanship of Dr. S. A. Dave was set up to frame regulations for such schemes. Based on the recommendations of the Dave Committee, SEBI has notified regulation on 15th October 1999. The salient features of the Regulations are set out below:

1. The term "Collective Investment Scheme" has been defined in the Regulations. However, the definition of the term as inserted by the Securities Laws (Amendment) Act 1999 in the SEBI Act, 1992 overrides the definition in the Regulation.
2. CIS can be floated only by public companies registered under the provisions of the Companies Act, 1956. The company floating CIS shall have to seek registration with SEBI as Collective Investment Management Company (CIMC).
3. CIS shall be constituted as a two tiered structure comprising of a trust and a CIMC.
4. At the time of application for Registration as CIMC, these entities should have a minimum networth of Rs. 3 crore which shall have to be increased to Rs. 5 crore.
5. Every Scheme shall have to compulsorily file offer documents with SEBI containing adequate disclosures to enable the investors to take informed investment decisions.
6. Each scheme shall have to obtain a rating from a recognised credit rating agency. The projects being undertaken must also be appraised by an empanelled appraising agency.
7. The schemes are prohibited from guaranteeing assured returns. Indicative returns, if any, provided by the scheme shall be based on the projections in the appraisal report.
8. Advertisements in respect of every scheme shall have to conform to the SEBI's advertisement code.
9. No scheme shall be kept open for subscription for a period of more than 90 days. The schemes shall be close ended in nature. The schemes must indicate the minimum and maximum amount proposed to be raised over this period.
10. The duration of the schemes shall be for a minimum period of 3 years.
11. Compulsory Insurance cover for the assets of the scheme and personal indemnity cover for the CIMC shall be obtained.
12. Units issued under the CISs are to be compulsorily listed on recognised stock exchanges.
13. Accounting/valuation norms as stipulated shall have to be followed by CISs.
14. Initial Issue Expenses : The initial issue expenses for schemes of duration of upto 8 years shall not exceed 7 per cent of the corpus mobilised and for schemes of duration exceeding 8 years shall not exceed 9 per cent of the corpus mobilised.
15. The management fees payable to CIMC shall consist of basic fee and Incentive fee. The 'basic fee' shall not exceed:
    - i. 1.00 per cent each year of the funds raised under the scheme for the first five years of the operation of the scheme.
    - ii. 1.25 per cent each year of the funds raised under the scheme for the next five years of the operation of the scheme.
    - iii. 1.50 per cent each year of the funds raised under the scheme for the subsequent period thereof till the termination of the scheme.

    The incentive fee shall not exceed 25 per cent of the excess return realised over and above the indicative return as shown in the offer document (excluding the unit capital) at the time of the termination of the scheme. In case, the return at the time of termination of the scheme is less than or equal to the indicative return as shown in the offer document, then no incentive fee shall be paid.

Existing CISs as on the date of notification of the SEBI regulations would be treated as existing CIS and would need to seek registration from SEBI within a period of 2 months from the date of notification. They would be considered for grant of a provisional registration and given some time to comply with the provisions of the regulations. The existing CIS would also have to abide by the directions of the Honourable Courts in various matters in this regard.

Securities Laws (Amendment) Act, 1999

The Securities Laws (Amendment) Bill, 1999 was introduced in Lok Sabha on 28th October 1999. This Bill incorporated the amendments proposed in the Securities Contracts Regulation (Amendment) Bill, 1998 as well as the modifications suggested by the SCF. The Lok Sabha passed the Bill on 30th November and the Rajya Sabha on 1st December 1999. It became the Securities Laws (Amendment) Act 1999 on receiving the assent of the President on 16th December 1999. The Act would come into force on such date as the Central Government may, by notification in the official Gazette, appoint.

In order to strengthen the hands of SEBI to protect interests of investors in plantation companies, the Act has amended the definition of "securities" so as to include within its ambit the units or any other instruments issued by any CIS to the investors in such schemes. The Act also inserts a definition of the CIS in the Securities and Exchange Board of India Act, 1992. The CIS has been defined to mean any scheme or arrangement made or offered by any company under which (a) the contributions, or payments made by the investors, by whatever name called, are pooled and utilised solely for the purposes of the scheme or arrangement; (b) the contributions or payments are made to such scheme or arrangement by the investors with a view to receive profits, income, produce or property, whether movable or immovable from such scheme or arrangement; (c) the property, contribution or investment forming part of scheme or arrangement, whether identifiable or not, is managed on behalf of the investors; and (d) the investors do not have day to day control over the management and operation of the scheme or arrangement. The CIS, however, does not include any scheme or arrangement (a) made or offered by a cooperative society, (b) under which deposits are accepted by non banking financial companies, (c) being a contract of insurance, (d) providing for any Scheme, Pension Scheme or the Insurance Scheme framed under the Employees Provident Fund and Miscellaneous Provision Act, 1952, (e) under which deposits are accepted under section 58A of the Companies Act, 1956, (f) under which deposits are accepted by a company declared as Nidhi or a mutual benefit society under section 620 A of the Companies Act,1956, (g) falling within the meaning of Chit business as defined in clause (d) of section 2 of Chit Fund Act,1982 and (h) under which contributions made are in the nature of subscription to a mutual fund. The Act empowers the Central Government to make rules to provide for the requirements, which shall be complied with by CIS for the purpose of getting their units listed on any stock exchange.

Market Trend

Several guestimates circulate indicating the amount of raised (or, swindled) by the so-called CIS. The schemes which wanted to carry on operations, pending notification of the regulation by SEBI, were directed to submit information about their schemes to SEBI. Such information was received only from 654 entities which have reportedly raised Rs. 2589 crore.

Regulations for CIS framed and notified by SEBI in October 1999 required registration by CIS within two months. By the dead line, only 10 out of about 700 registered with SEBI.