INDIA

SECURITIES

SUMMARY

While India's capital markets have a long history, it is only recently that they have grown significant in size. At present, there are 22 accredited stock exchanges in India, including the National Stock Exchange (NSE) and Over-the-Counter Exchange of India (OCTEI), serving an estimated 30 million investors. Twenty of the exchanges have computer trading systems. The market includes about 9,890 listed companies, over 8,900 brokers (27 percent are corporate brokers) supported by an estimated 100,000 sub-brokers throughout the country, close to 1,000 financial institutions offering merchant banking services, 36 mutual funds with a total corpus of over Rs 22 billion (US$56 million), and four credit rating agencies. A wide variety of equity and fixed income instruments are available to investors. The stock exchanges have become important sources of financing for Indian corporations, reducing the previously dominant role of commercial banks and state-owned financial institutions. In addition, there are market participants such as registrars, transfer agents (issue bankers that distribute and collect share applications), and securities custodians. The National Securities Depository was established in 1996 to allow for paperless trading of shares and to improve deliveries for market participants. It is expected that in the near future, trading in equity derivatives will be introduced in India.

At the end of the Indian fiscal year 1997-98 (IFY 97-98), total market capitalization of Indian stock exchanges stood at Rs 5,898 billion (US$150 billion). Capital raised through primary issues of equity securities, bonds, and other instruments increased from Rs 2 billion (US$5 million) in IFY 80-81 to Rs 276 billion (US$7 billion) in IFY 93-94, but subsequently declined to Rs 46 billion (US$1.2 billion) in IFY 97-98. The decline was partly due to the strengthening of disclosure norms for new issues, to the availability of alternative methods of raising funds, and to industrial slowdown. Mutual funds increased Rs 134 billion (US$3.4 billion) during IFY 97-98.

Much of the growth in India's markets has been driven by the economic reforms in the wider economy, which freed industry from controls on investment and expansion. These were supplemented by regulatory reforms and infrastructure development in the securities markets, many of which were initiated by the Securities and Exchange Board of India (SEBI). Companies are now allowed to issue equity at market determined prices, the issue process has been made more flexible, and India's capital markets have been opened to foreign investors. Tax concessions on long-term capital gains and dividend payments were also introduced.

Several U.S. financial institutions participate in Indian capital markets in various capacities. U.S. and other foreign financial institutions have established joint ventures with Indian financial institutions in the areas of investment banking, asset management, and consumer finance. U.S. financial institutions have also been active in underwriting offshore securities issues by Indian companies, and in managing and marketing mutual funds. In addition, institutional investors from

the United States constitute the largest number of foreign institutional investors (FIIs), accounting for approximately 60 percent of cumulative net FII investment. With the approval of the Foreign Investment Promotion Board and the Reserve Bank of India, foreign investors can also invest in domestic capital venture funds, in the form of trusts or companies, according to the Guidelines for Overseas Venture Capital.

SEBI is responsible for the development and regulation of India's securities, investor protection, and collaboration with the government and the Reserve Bank of India on securities market development.

FIIs may make portfolio investments in local stock markets, subject to registration requirements and certain investor ceilings. However, foreign individuals and foreign corporate bodies are not permitted to make portfolio investments in the shares of Indian firms. Foreign investors have been concerned by inadequate custodial facilities, lack of transparency in trading operations, and a weak clearance and settlement system. Several measures have been introduced by SEBI, the Indian government, and the stock exchanges to address these issues. The most significant measure has been the enactment of legislation facilitating the dematerialization of securities in a depository and settlement by electronic book entry.

The National Securities Depository Limited began operations in 1996. There are now over 50 participants, including all custodian banks used by foreign investors, and substantial dematerialization of share holdings of institutional investors in eligible securities has already taken place. SEBI is taking steps to make settlement through the depository of all trades on Indian stock exchanges compulsory in a phased manner.

Indian residents are not permitted to invest in foreign securities. Indian companies may raise funds overseas through issues of Global Depositary Receipts (GDRs), American Depositary Receipts (ADRs), and convertible bonds. In May 1998, these guidelines were liberalized to permit previously unlisted companies to issue GDRs and ADRs and removed some existing restrictions on the end use of funds raised through such issues.

DESCRIPTION OF THE MARKET

Capital Market Growth

The present process of economic reform, which began in 1991, has focused on increasing the output, efficiency, and competitiveness of Indian industry at home and abroad by pulling down artificial entry barriers for industry, removing restrictions on growth in the size of firms, and eliminating licensing requirements. Reform of the financial services sector, especially the securities markets, has been at the very heart of this effort. The aim has been to create a much larger role for the private sector in the economy and to allocate capital more efficiently through market mechanisms. This has

led to an expansion of markets in terms of primary issues, secondary market trading, introduction of new instruments, institutionalization, and development of well-capitalized and professionally run intermediaries.

The market includes, of 9,890 listed companies, over 8,900 brokers (27 percent of which are corporate brokers) supported by an estimated 100,000 sub-brokers throughout the country, close to 1,000 financial institutions offering investment banking services, 36 mutual funds with assets of over Rs 22 billion (US$56 million), and four credit rating agencies.

Capital raised through new equity issues, bonds, and other capital market instruments totaled Rs 46 billion (US$1.2 billion at an exchange rate of Rs 39.4 equals US$1) in IFY 97-98 versus only Rs 2 billion (US$5 million) in IFY 80-81. In IFY 93-94, Rs 276 billion (US$7 billion) were raised. The decline may be due to strengthening of disclosure norms for issues and to the availability of alternative methods of raising funds. However, this was partly offset by the spurt in capital raised through the private placement route, mainly debt instruments of public sector companies and institutions.

In addition to conventional equity/preference shares and debentures, Indian securities firms are now able to offer a wide variety of securities products: triple-option convertible bonds, deep-discount bonds, zero-interest partly convertible debentures, cumulative convertible redeemable preference shares, equity shares with detachable warrants, and floating rate bonds. Indian firms no longer limit themselves to raising funds earmarked for individual projects; they use capital proceeds to retire debt, invest in subsidiaries, and provide working capital. Some foreign banks and nationalized banks offer over-the-counter trading for government bonds.

Stock Exchanges

There are presently 22 stock exchanges, including the NSE and OCTEI, serving an estimated 30 million investors. The largest stock exchanges are in Mumbai, Calcutta, Madras, Delhi, and Ahmedabad. Out of the 22 stock exchanges, Ahmedabad, Mumbai, Calcutta, Delhi, and the NSE accounted for over 90 percent of total turnover in IFY 96-97, and out of the stocks traded at the Bombay Stock Exchange (BSE, in Mumbai), less than 20 percent are traded heavily. Automated screen-based trading, which was introduced through the establishment of the OTCEI and NSE and subsequently introduced by the BSE, has brought about a qualitative improvement in the market and its transparency. Twenty stock exchanges now have screen-based trading systems. This implies that today, 98.8 percent of trading takes place on screen-based systems. The BSE has also expanded its trading network outside of Mumbai, and now covers 118 cities across the country with its computer trading system. Together, the NSE and BSE cover over 250 centers across the country through their trading networks. The smaller exchanges are also in the process of inter-connecting their trading systems to provide cross-market execution to their members. The stock exchanges are managed by

their governing boards and executive directors, which establish their operating rules. They are subject to regulations by the Ministry of Finance and the SEBI.

The ratio of market capitalization of the BSE to GDP rose from 12.1 percent in IFY 89-90 to 33.9 percent in IFY 96-97. Similarly, trading volume in the BSE increased more than four times during the same period. As of March 1998, the All-India market capitalization of all companies listed on stock exchanges was Rs 5,898 billion (US$150 billion). Total turnover on the stock exchanges as of the end of March 1997 was Rs 6,461 billion (US$164 billion). Market capitalization at the BSE, as of the end of March 1997, was Rs 2,624 billion (US$66 billion). The average price/earnings (P/E) ratio (Sensex) of listed companies was 15.65 in March 1998, compared to a P/E of 14.81 a year earlier. The following table provides data on selected major stock exchanges (many of which list the same stocks), with capitalization expressed in billions of rupees, as of March 31, 1997:

Major Stock Exchanges
Composition of Market Capitalization as of March 1997

Stock Exchanges	Regional Firms Listed	Market Capitalization (Billions of rupees)
1. Mumbai	1,810	2,624.04
2. Calcutta	1,875	407.18
3. Delhi	1,744	370.33
4. Madras	664	327.27
5. Ludhiana	290	184.96
6. Uttar Pradesh	347	158.02
7. Hyderabad	619	113.10
8. Pune	173	110.85
9. Bangalore	255	96.99
10. Cochin	140	95.36
11. Ahmedabad	676	92.46
12. Vadodara	325	72.94
13. NSE	7	57.71
14. Madhya Pradesh	268	46.38
15. Jaipur	179	31.48
16. Mangalore	20	29.19

Stock Exchanges	Regional Firms Listed	Market Capitalization (Billions of rupees)
17. Saurashtra Kutch	43	26.53
18. Coimbatore	96	10.94
19. Gauhati	170	10.20
20. Bhubaneshwar	46	10.04
21. OTCEI	108	4.18
22. Magadh	35	2.76
TOTAL OF ABOVE	9,890	4,882.91

Turnover on Indian Stock Exchanges
(Billions of rupees)

	IFY 96-97	IFY 97-98
1. NSE	2,945.04	3,699.34
2. Mumbai	1,242.84	2,073.83
3. Calcutta	1,056.64	1,787.78
4. Delhi	486.31	678.40
5. Ahmedabad	205.33	307.71
6. Uttar Pradesh	160.70	153.90
7. Bangalore	43.98	86.36
8. Pune	99.03	86.24
9. Ludhiana	52.74	83.15
10. Vadodara	42.68	45.76

Source: SEBI

OTCEI, an over-the-counter electronic trading system, is for small investors and small companies. It commenced operations in September 1992 in Bombay and is similar to the National Association of Securities Dealers Automated Quotation Market in the United States. In late 1993, it began operating regional windows in Delhi and Madras, and now has representative offices in 23 major cities.

The NSE has emerged as the dominant stock exchange of the country, accounting for nearly 60 percent of the total trading turnover on all the stock exchanges. The NSE is an automated stock exchange that has introduced screen-based trading throughout the country. The NSE began on-line trading in the debt market in June 1994 and the equity segment of the NSE became operational in November 1994. It has spread its operations to 179 cities across 18 states. In addition to equities, the NSE offers a trading facility for wholesale corporate and government debt. Its central computer in Mumbai is linked to market participants around the country via a satellite network.

SEBI is responsible for the development and regulation of India's capital markets, investor protection, and advising the government on capital market development. It was constituted as a non-statutory body on April 12, 1988, and given regulatory authority on January 30, 1992. SEBI has drafted and issued a variety of regulations governing transactions by stockbrokers, investment bankers, portfolio managers, and mutual funds. SEBI has also issued regulations governing substantial acquisitions of shares and takeovers, foreign institutional investors, and venture capital funds. Prior to SEBI's establishment, functions relating to the issue of capital and its pricing were handled by the Controller of Capital Issues within the Ministry of Finance, under the authority of the Capital Issues (Control) Act, 1947 (repealed on May 29, 1992).

Securities are traded on the stock exchanges through a limited number of licensed brokers, but a large number of sub-brokers and their agents operate through the registered brokers. SEBI has imposed stricter requirements on brokers in recent years, requiring registration and stricter financial disclosure norms. It also has pushed to have brokers clearly separate trading on their own account from trades executed for customers.

A new carry forward system was introduced in October 1995 replacing the "badla" system, which was considered to be speculative and inequitable and was banned by SEBI in March 1994. The BSE implemented a new system which included: special safeguards, including margins; limits on the number of days transactions could be carried forward; and separation of carry forward trades from those for settlement.

One recent development is the formation of the Federation of Indian Stock Exchanges (FISE) by 12 regional stock exchanges. Their next step is to set up a central trading system through inter-connectivity; for this purpose they formed a body called the Indian Stock Exchanges Services Corporation (ISESC). If FISE succeeds in setting up an all-India trading system through ISESC, there will be three entities with a national stature: the NSE, the BSE, and the ISESC.

There are four credit rating agencies in operation in India: the Credit Rating Information Services of India Ltd. (CRISIL), the Investment Information and Credit Rating Agency of India Ltd. (ICRA), the Credit Analysis and Research Ltd. (CARE), and Duff and Phelps. These agencies generally rate the debt instruments of firms seeking to raise resources from the capital market. Recently, SEBI formulated a new set of tough guidelines to regulate private debt placements, which had previously

not been required to obtain ratings. The new guidelines state that any issue having more than 100 investors will be considered a public issue. Ratings are mandatory for publicly issued debt instruments with maturity periods, even if the maturity period is less than 18 months.

Foreign financial institutions may act as securities custodians. Currently there are 14 securities custodians operating in the Indian market, including the Stock Holding Corporation of India, Ltd., Hongkong and Shanghai Bank, Citibank, Standard Chartered Bank, the State Bank of India, Deutsche Bank, ANZ Grindlays, and Morgan Stanley Trust Company.

There are a number of major problems facing Indian stock exchanges, including lack of transparency, inadequate custodial services, and delays in physical delivery of certificates. Delivery may take up to six months, although generally 50 percent of the total value of the transactions must be paid at the time of purchase. These problems have been addressed by the introduction of screen-based trading on most exchanges, the settlement of transactions by electronic book entry, and the establishment of a depository. Measures have also been taken by SEBI to make settlement of trades in a depository compulsory in a phased manner.

The 1997-98 budget reduced the corporate tax rate from 43 percent to 35 percent for domestic companies and from 55 percent to 48 percent for foreign companies. The tax rate for nonresident Indians on capital gains on securities sales was reduced from 20 percent to 10 percent. In addition, dividend income received from a domestic company is exempt from tax in the hands of the shareholder. Companies pay an additional tax of 10 percent on dividends declared, distributed, or paid.

The institutional infrastructure in the government securities market has been strengthened with the system of primary dealers announced in March 1995 and that of satellite dealers in December 1996. At present six primary dealers are in operation and nine companies have been registered as satellite dealers.

The U.S. Agency for International Development (USAID), in consultation with the Indian government, administers a Financial Institutions Reform and Expansion (FIRE) project. The project is designed to help India's capital markets adopt "best practices" in market regulation, oversight, and enforcement to improve market transparency. It also assists in modernizing the operating systems used in the capital markets to promote efficiency and reduce high levels of systemic risks, thereby bolstering investor confidence in the transparency and fairness of the market.

The National Securities Depository Limited (NSDL)

The Depositories Act of 1996 paved the way for the establishment of depositories in India. It permits transfer of securities through electronic book entry, leading to better investor service and protection. As a result of this Act, the NSDL was established and began operations in October 1996,

sponsored by Industrial Development Bank of India, Unit Trust of India, and the NSE. NSDL carries out its operations through participating companies and the clearing corporations of the various stock exchanges. The participants act as market intermediaries through whom NSDL interacts with the investors and clearing members. Since only the NSE has a clearing corporation, the National Securities Clearing Corporation Limited (NSCCL), which guarantees performance of trade obligations and has been admitted into the depository, only the capital market segment of the National Stock Exchange has been associated with NSDL at this point. As of April 30, 1998, total market capitalization signed up for dematerialization with NSDL stood at Rs 3,298 billion (US$83 billion), which accounted for nearly 55 percent of the total market capitalization of all the listed companies in the country. In a bid to give a push to the depository system, SEBI has decided to make it compulsory for all institutional investors to settle their trades through the depository. These include banks, mutual funds, and FIIs having a minimum portfolio of Rs 100 million (US$2.5 million) as of the latest balance sheet.

Incorporation of Brokers

There were 8,867 brokers on the various stock exchanges in India as of March 1997. Until recently, brokerage houses were generally partnership firms. Consequently, the brokers were poorly capitalized with little, if any, capability to do equity research and provide comprehensive and relevant market information. There was no apparent link between a brokerage's capital base and its risk exposure. In an effort to encourage brokerages to adopt a corporate business form, the government granted in its 1997-98 budget a one-time exemption on capital gains tax for the conversion of partnerships into corporations. This exemption has been extended by the government for a second year in the 1998-99 budget.

Some of the top FIIs operating stock brokerages in India reported losses in IFY 96-97. Among the FIIs that reported losses were Morgan Stanley India Securities, Jardine Fleming India Broking, Peregrine Securities, HG (India), James Capel Batlivala & Karani Securities (now HSBC B&K), ING Baring Securities, Birla Marlin Securities, and Credit Capital Securities. The three FIIs that made profits were Crédit Lyonnais Securities India, UBS Securities, and DSP Merrill Lynch.

Stock Lending

Following changes in tax regulations in the recent budget which proposed that lending of securities would not attract capital gains tax, a proposal designed to facilitate stock lending in a regulated manner has been introduced. Stock lending can now take place through an intermediary which is registered for this purpose with SEBI and has a minimum capital of Rs 500 million (US$13 million). Lenders and borrowers of securities have to enter into agreements with the intermediary. The introduction of stock lending will facilitate the timely settlement of transactions on the stock exchanges, especially in an environment that requires physical delivery of certificates for settlement.

Derivatives

As a starting point for equity derivatives in India, SEBI has approved the phased introduction of trading stock index futures on existing stock exchanges. The exchanges have been permitted to trade derivatives subject to fulfilment of the eligibility conditions prescribed by the L.C. Gupta Committee report, including provision of adequate infrastructure, the use of an on-line trading and surveillance system, and participation of a minimum of 50 members in derivatives trading. SEBI has announced that mutual funds must make necessary disclosures in their offer documents if they intend to trade in derivatives. The NSE and the CRISIL have set up a new company for indexing and will put out various equity indices in technical collaboration with Standard and Poor's of the United States. The indices NSE 50 and CRISIL 500 will henceforth be known as S&P CNX Nifty and S&P CNX 500. The current Securities Exchange Contracts Regulations Act needs to be amended to redefine securities to include derivatives such as futures and options.

Forward markets are regulated by the Forward Markets Commission. The Forwards Markets Commission (FMC) is a statutory body set up by the government of India under the Forwards Contracts Act of 1952. The act provides for the regulation of matters relating to forward contracts, the prohibition of options on goods, and related matters. The Commission functions under the Department of Consumer Affairs, Ministry of Food and Consumer Affairs, and thus is not independent. At present, the FMC has two members. It is headquartered in Mumbai and has a regional office in Calcutta. The FMC has three functional wings: the Commodity division, the Enforcement division, and the Administration division.

A domestic futures market has operated for several years under the Spices Association in Cochin. A recently-started International Pepper Exchange has seen little activity as domestic exporters prefer to hedge in the domestic futures market and international interest has so far been small. There are plans for a cotton futures market in Mumbai.

At present, futures trading is regulated through 17 recognized associations in seven commodities: castor seeds, pepper, tumeric, potatoes, gur, hessian, and jute goods.

Mutual Funds Industry

The government has permitted mutual funds to be established both in the government and the private sector. Unit Trust of India is the dominant player in the public sector, with a market share of about 80 percent, and Life Insurance Corporation and the General Insurance Corporation also have large mutual funds.

The promulgation of SEBI's mutual fund regulations in 1993 brought about a restructuring of the mutual fund industry. An arm's length relationship was required between the fund sponsor, trustee, custodian, and asset management company. The regulations prescribed disclosure and advertising

norms for mutual funds and, for the first time, permitted the entry of private mutual funds, some of which have U.S. participation in their asset management companies. These regulations were revised in 1996 to improve investor protection, to facilitate competition by removing unnecessary regulation, and to encourage innovation and flexibility. Guidelines for money market mutual funds have also been issued. Mutual funds in India are exempt from taxation; income from investment in mutual fund schemes is taxed in the hands of investors. Foreign financial institutions established in India may manage local mutual funds. Foreign asset management companies may also set up joint ventures to manage some of the domestic mutual funds, but they must be registered with the SEBI.

The mutual fund industry is still in its early stages of development in India and has not had a stellar performance record in recent years, largely due to weak capital markets. India's 33 mutual funds mobilized Rs 134 billion (US$3.4 billion) in IFY 97-98, adding to cumulative assets of Rs 979 billion (US$25 billion) at the end of IFY 96-97. The industry suffers from poor product image, lack of self–regulation and transparency, inadequate disclosure norms, and weak accounting standards. The Association of Mutual Funds has been established to bring about structural and quantitative improvement in the mutual fund industry.

Foreign Investment in Venture Capital Funds

Venture capital funds may be set up as companies or trusts. Regulations permit venture capital funds to raise money only from institutional and high net worth individuals. The minimum amount that may be raised from any investor is Rs 500,000. The only investment restriction that has been prescribed is that at least 80 percent of the funds raised by a venture capital fund or trust may be invested in unlisted companies and financially weak companies (listed or unlisted) or used to provide loan assistance to investee ventures. Venture capital funds are exempt from taxation, provided that they invest in certain sectors of the economy designated by the tax authorities and such investment, among other requirements, is for a minimum period of three years. Venture capital funds may invest up to 20 percent of their assets in the equity of any single company.

Foreign investors may invest in domestic capital venture funds, whether set up as trusts or companies. This investment is governed by the Guidelines for Overseas Venture Capital Investment. The initial investment in the domestic venture capital fund by an overseas investor requires the approval of the Foreign Investment Promotion Board (FIPB) and the Reserve Bank of India (RBI); however, approval for subsequent investment by the venture capital fund into investor ventures is not necessary.

Foreign Institutional Investment

Issuance of the guidelines for Foreign Institutional Investment in September 1992 invited FIIs to invest in Indian securities markets. In September 1995, the SEBI (Foreign Institutional Investors) Regulations, 1995 came into effect. The regulations require FIIs to register with SEBI and to obtain

approval from the RBI under the Foreign Exchange Regulation Act to buy and sell securities, to open foreign currency and rupee bank accounts, and to remit and repatriate funds. Once SEBI registration has been obtained, no further permission is needed to buy or sell securities or to transfer funds in and out of the country, subject to payment of applicable taxes.

FIIs such as foreign pension funds, foreign mutual funds, and foreign investment trusts, insurance or reinsurance companies, government agencies, multilateral agencies, and endowment funds can invest in domestic Indian securities. Shares held by all FIIs combined may not exceed 24 percent of the issued capital of the Indian company. The limit can be raised to 30 percent with the approval of the board of directors of the company concerned. The ceiling on holdings by an individual FII (or its sub-accounts) is 10 percent of the total issued capital of the Indian company.

Investment in Indian securities is also possible through the purchase of Global Depositary Receipts, Foreign Currency Convertible Bonds, and Foreign Currency Bonds, which are all listed, traded, and settled overseas. These instruments are generally denominated in U.S. dollars.
Foreign investors, whether registered as FIIs or not, may also invest in Indian securities, with approval from the FIPB in the Ministry of Industry and the RBI. In some cases, only RBI approval may be necessary, depending on the size of investment and the industry in which the investment is to be made.

The government recently opened the government securities market to all FIIs. It has permitted FIIs to lend securities and eased the lock-in norms for preferential allotments. FIIs can invest in primary and secondary markets including shares, debentures, and warrants of companies which are listed (or soon to be listed) on a recognized stock exchange in India. FIIs are allowed to invest in units of instruments floated by the Unit Trust of India and other domestic mutual funds, whether listed or not. FIIs are also allowed to make equity investments in unlisted companies, but must channel transactions through authorized Indian companies. Both FIIs with a ceiling of 30 percent investment in debt instruments and those in the category of 100 percent debt funds are permitted to invest in government debt securities. The RBI has restricted FII investments to a prescribed debt ceiling in order to safeguard against a potential negative development that may result from foreign investment in short-term debt. These investments are subject to an annual cap within the overall external commercial borrowing limits, currently in the region of US$9.5 billion. The government has also recently allowed FIIs to invest in treasury bills. Proprietary funds are also permitted to make investments through the FII route subject to the condition that they are subject to their home regulators or are registered with their tax authorities.

FIIs enjoy a concessional tax rate of 10 percent on long-term capital gains (securities held for 12 months or more), and 30 percent on short-term capital gains (securities held for less than 12 months). Dividends and interest income are taxed at a rate of 20 percent. Indian firms pay 20 percent on profits earned on equity securities. The final tax incidence may be different if investors take

advantage of bilateral double taxation treaties, which India has signed with 40 countries, including the United States, the United Kingdom, Japan, Germany, and France.

To meet Indian requirements, FIIs must be regulated by an appropriate foreign regulatory authority, such as a securities regulator, central bank, or other government agency. Registration with foreign authorities that are responsible for incorporation is not, by itself, enough to meet this requirement. FIIs must also have a track record of two to three years of operations.

Foreign financial service institutions have also been allowed to set up joint ventures with Indian partners in stock brokerage companies, asset management companies, investment banking, and other financial services firms. Foreign participation in financial services requires the approval of the FIPB.

The Ministry of Industry has permitted foreign investors in foreign exchange brokerage services in addition to a range of 14 nonbank financial services where foreign equity investment has already been permitted. These 14 activities include merchant banking, underwriting, portfolio management services, investment advisory services, financial consultancy, stock brokerage, asset management, venture capital, custodial services, factoring, credit reference agencies, credit rating agencies, leasing, and housing finance.

All investment proposals must be routed through the FIPB. One hundred percent foreign-owned foreign exchange brokerage firms have been allowed to act only as holding companies. Specific activities will have to be undertaken by subsidiaries with a minimum domestic equity of 25 percent. Domestic equity in the subsidiaries of 100 percent foreign-owned companies may be phased by starting with 10 percent domestic equity and increasing the percentage over a period of 24 months.

As of May 26, 1998, 502 FIIs were registered with SEBI (about 150 are active in the market) and had made cumulative net investments of US$9.1 billion. As of the same date, 17 approvals have been given for 100 percent debt investments for a total allocation of US$2.52 billion. Of these, five FIIs have become active and have made cumulative net investments of US$97 million.

International Issues

Although Indian residents are not permitted to purchase foreign securities, the RBI permits Indian firms to raise funds overseas, but only through issues of Global Depositary Receipts (GDRs) or convertible bonds that can be listed overseas and are mainly denominated in U.S. dollars. American Depositary Receipts (ADRs) are also permitted, but Indian firms find it difficult to meet SEC listing standards. Indian firms have successfully launched Euro-issues in overseas markets. Early in 1993, several large firms entered the international markets by issuing GDRs convertible bonds. Based on their success, smaller firms also entered the market to raise funds for modernization and expansion,

to reduce/retire debt, and to set up overseas subsidiaries. As of June 1998, Indian issuers have placed 76 GDR issues and raised US$7,432 million in Foreign Currency Convertible Bonds.

U.S. PRESENCE IN THE MARKET

U.S. Securities Firms and Financial Institutions

Several U.S. companies have joined with Indian partners to offer financial services in India. J.P. Morgan had a 40 percent joint venture with Industrial Credit and Investment Corporation of India (ICICI) for investment banking and stock brokerage services. J.P. Morgan also had a joint venture with ICICI for asset management. They have decided to part ways and J.P. Morgan has been granted approval to set up a securities and investment banking firm with up to 75 percent held by J.P. Morgan and the remaining by an Indian partner, yet to be identified. J.P. Morgan has also been granted approval for a full bank branch.

Morgan Stanley has a 75 percent stake in an asset management company, which operates a mutual fund, as well as in two securities firms, one for investment banking and one for stock brokerage services. Morgan Stanley has announced that it will enter into joint ventures with Jamnadas Morajee, a leading domestic investment banking and securities group. Morgan Stanley Trust Company has a branch in Mumbai, which offers custodial services to FIIs. This activity is likely to be taken over by the Chase branch in Mumbai following the sale of Morgan Stanley's custody and trust businesses to Chase Manhattan Bank.

Numerous other large U.S. financial firms have affiliated with Indian firms, including Merrill Lynch, Goldman Sachs, Kemper Financial Services, and GE Capital Corporation.

Several U.S. investment banks have been lead underwriters of GDRs and foreign currency convertible bonds and have been appointed as lead managers for overseas issues in government disinvestment programs designed to reduce the government's holding in selected public sector firms.

SHCIL plans to become a global custodian and expects to diversify into the securities lending business and retail custodial services as well as operate a limited purpose bank. SHCIL has already begun negotiations with the U.S. SEC for necessary approvals for the global custodian business and will adhere to international capital adequacy norms prescribed by the SEC.

Investment by U.S.-Based FIIs

The largest number of FIIs registered with SEBI are from the United States. These companies account for about 60 percent of cumulative net investment by FIIs in India. Six financial institutions

have also been granted approvals by SEBI for establishing funds to invest entirely in Indian debt securities. Planned investment totals about US$840 million.

The Banking Regulation Act was amended in 1983 to permit commercial banks to establish investment banking subsidiaries. Among the public sector banks and foreign banks active in this sector are:

- public financial institutions such as the Industrial Credit and Investment Corporation of India (ICICI) and Industrial Finance Corporation of India (IFCI);
- commercial banks such as State Bank of India, Canara Bank, Grindlays, Citibank, and Standard Chartered; and
- private nonbank finance companies such as JM Financial and Investment Consultancy Services, the Credit Capital Group, Champaklal Investment and Financial Consultancy, and DSP Financial Consultant Ltd.

TREATMENT OF U.S. FINANCIAL INSTITUTIONS

There is no limit on the extent of foreign equity participation in financial subsidiaries engaged in securities activities; however, they are subject to minimum capital requirements and approval from the FIPB, RBI, and SEBI for foreign ownership. The Indian government is flexible on whether investment banks can establish 100 percent foreign-owned entities.

The RBI permits the opening of representative offices by foreign securities firms, provided that the office earns no income and all expenses are paid by remittances from abroad.

Although Indian residents are not allowed to invest in portfolio securities overseas, Indian companies are permitted to issue equity and equity-related instruments to international investors with RBI permission. U.S. investment banks may underwrite international offerings by Indian firms.

The major barriers to market access in the securities industry that have yet to be addressed by the Indian government include: (1) the removal of discriminatory restrictions on the ability of FIIs to trade for their own account or for the account of customers; and (2) the inability of foreign securities firms to operate on the Indian stock exchanges directly instead of working through registered Indian brokers to execute transactions.

India's GATS offer makes very few commitments. In general, actual practice is more liberal than commitments made in the offer. For example, the offer binds India to allow up to 51 percent foreign equity in foreign financial services companies, but in practice the government routinely approves

higher levels of foreign equity, up to 100 percent. There is continued reform and liberalization in the securities sector, which goes well beyond the GATS offer.