REPORT OF THE COMMITTEE ON TRADING IN PUBLIC SECTOR BONDS & UNITS OF MUTUAL FUNDS

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CHAPTER I

INTRODUCTION

1.1 The Reserve Bank of India (RBI), set up (vide its Memorandum dated June 9, 1992 set out in Annexure I), a committee to evolve an improved procedure for conducting transaction in public sector bonds (PSU Bonds) and units of mutual funds. The Committee was set up in pursuance of one of the recommendations of the Committee to enquire into the Securities Transactions of Banks and Financial Institutions (popularly known as Janakiraman Committee).

1.2 The terms of reference for the Committee required it to evolve improved procedures based on examination of the existing procedures for transactions in PSU bonds and units mentioned above with a view to eliminating deficiencies including those in the practice of issuing bankers' receipts (BRs). The Committee was also required to recommend modalities of an alternative system covering booking of transactions and efficient methods of accounting and transfers.

1.3 The Committee had discussions and formal meetings with a number of persons including groups representing Indian Banks, branches of foreign banks operating in India, mutual funds, brokers and public sector units. The Committee also had discussions with the Chairman of Securities and Exchange Board of India, a partner of Amarchand & Mangaldas & Hiralal Shroff & Co., solicitors, and the President and the Executive Director of Bombay Stock Exchange. The Committee also had the benefit of meeting members of the Janakiraman Committee, Annexure-II sets out the persons with whom the Committee had the meetings.

1.4 The Committee received written notes from some of the persons they met. The Committee also carefully studied the two interim reports submitted by the Janakiraman Committee, the relevant provisions of the Securities Contracts (Regulation) Act, the presentation on National Clearance & Depository System made by Price Waterhouse to the Stock Holding Corporation of India Ltd. and also some of the available literature on the systems already operating in other countries.

1.5 The Committee takes this opportunity to record its sense of appreciation for the assistance received from the above mentioned and other sources and more specifically for the contribution made to its deliberations and the drafting of the report by D. Basu, Dy. Managing Director, State Bank of India (SBI), R.H. Patil, Executive Director, the Industrial Development Bank of India (IDBI) and K.N. Atmaramani, Chief General Manager, Unit Trust of India (UTI). The Committee also thanks IDBI and SHCIL for secretarial assistance.

<u>Approach of the Committee</u>

1.6 The Janakiraman Committee reports bring out clearly that number and value of transactions, which resulted in irregularities related in no insignificant part to trading in public sector bonds and units.

1.7 The number and value of the transactions which have taken place from April 1, 1991 to May 31, 1992 and the velocity of trading that they have generated as given in the Second Interim Report of the Janakiraman Committee are large. While no separate figures are available in the Report regarding PSU Bonds and units, it can be inferred that their proportion in the total must be significant. What is more, in the First Interim report (pages 17 and 18) it is mentioned that value of transactions, which resulted in losses to National Housing Bank, State Bank of Saurashtra, SBI Cap, Standard Chartered Bank and Canfina were related mainly to PSU Bonds and Units.

1.8 The above and related findings of the Janakiraman Committee Report indicate importance of carefully looking into transactions of PSU bonds and units. Moreover, while the transactions in government securities are covered by the SGL system (which is now being modernised and computerised by the RBI), there is no such organised, regulated and transparent system covering other instruments. Improving transaction modalities for PSU bonds is also important from the point of view of funding needs of PSUs who are primary issuers of these bonds.

1.9 While the genesis of setting up of this Committee is to be found in the large scale irregularities and losses detected in the past few months, the Committee believes that an efficient and transparent system is vital not only to reduce such possibilities, but also for healthy growth of fixed yielding securities, which have and will continue to have an important place in the financial system.

1.10 In the light of this general approach, the Committee placed before itself the following objectives/criteria while suggesting a system for transacting the PSU bonds and units.

a. The system should provide for transparency in trading and for matching of sale and buy offers.

b. It should provide for efficient and expeditious transfer and settlement.

c. It should provide instant recording of transactions and reconciliation.

d. It should recognise that institutional players will continue to dominate the market for PSU Bonds and units.

e. It should suo moto throw up data on any unusual volume of transactions as also irregularities. It should also facilitate audit/supervision/inspection/regulation by authorities.

f. The recommendation should take cognisance of the existing ground level realities regarding incomplete and unreconciled transactions as also need for dovetailing present system into the new one. The recommendation should also recognise the present limitations of the communication and computing infrastructure; but at the same time this should not be an excuse for compromising on efficiency of the system.

g. In the light of the above as also time required for any legislative changes that may be called for, the Committee may have to consider phasing towards establishing an ideal system, but the telescoping of one phase into the other should not lead to either wasteful expenditure or create uncertainties in putting through transactions in the interim. The final system should be such as to facilitate global transactions, whenever opening at the markets becomes a reality in future.

h. The need for "maintaining liquidity" in all these instruments and therefore for not hindering use of these scrips for money market transactions should be recognised. Liquidity in PSU Bonds is particularly important so that PSUs remain in a position to raise funds through this instrument.

1.11 Subsequent chapters in the Report, which examine deficiencies in the existing system and make recommendations regarding the new systems follow this basic approach. The recommendations, in essence, cover setting up of an organised market arrangement for fixed yielding securities and an associated electronic book entry type clearing facility supported by a depouitory.

1.12 The Committee has also made recommendations for a phased programme towards the 'ideal' system as also dovetailing of existing arrangements into that system. The Committee has also suggested improvements in the existing procedures in the interim so as to prevent malpractices. While looking at the systemic issues, the Committee has taken the liberty of touching upon certain macro-aspects, which it considers germane to the subject before it.

1.13 The Committee while submitting this Report is acutely aware that while improvements and alternative procedures would certainly reduce to a great extent chances of irregularities and considerably enhance chances of early detection, they cannot provide a total answer to adventurism and lack of probity that could exist in certain human beings. In fact, no system can, unless there is a widespread change of values in the society and in the interim, supervisory regime is made active and vigilant, adherence of procedures insisted upon and enforced and exemplary punishments are meted out expeditiously to the errants. In this context, the Committee welcomes the recent decision announced by Government of India to set up a Supervisory Board.

CHAPTER II

MARKET FOR PSU BONDS AND UNITS

The Committee looked into various factors concerning the primary issues of PSU bonds and of Units as these form an important backdrop to their secondary transactions.

Bonds of public sector units

PSUs started raising bonds from 1985-86 onwards and presently the total issued and outstanding amount of PSU bonds is around Rs. 20,550 crore. These bonds, which are not guaranteed by Government and hence do not qualify for SLR investment, have been issued by 19 PSUs. Approximately, 55% of these have been issued in the form of tax-free bonds carrying coupon rate of 9% in the main and a relatively small amount at coupon rate of 10%. The taxable PSU bonds have been mostly issued at coupon rates of either 13% to 14%. Very few of the bonds carry coupon rates of 17% and 18%. These bonds generally have a maturity of 7 years. Only a few of the PSU bonds are listed on stock exchanges. All these bonds can be transferred by endorsement and delivery, although registration in the company's books has now become necessary because of different bases on which tax has to be deducted at source.

It may be observed that at times these bonds did not carry a realistic coupon rate in relation to the yield expectations. With the subsequent rise in the general interest structure, the gap further widened in the eyes of the existing holders of these bonds.

2.4 Generally, there were no marketing efforts put in by PSUs for popularising and dispersing these bonds. Instead, they were mostly placed with large bulk investors; namely, banks, mutual funds, corporates and PSUs having liquid funds. During 1990-91, out of total issues of Rs. 5463.2 crore PSU bonds, Rs. 5363.2 crore were privately placed with financial institutions, banks and their subsidiaries. These bulk investors tried to adjust their yield by non-transparent methods such as obtaining a discount on the purchase price, stipulating a lock-in period for part of the proceeds so that these are kept with the investor either as deposit or under portfolio management scheme (PMS).

2.5 In the case of tax-free bonds, they provided a special attraction for high bracket tax-payers amongst these bulk investors like the foreign banks operating in India.

2.6 These aspects connected with primary issues of the PSU bonds were reviewed by the Committee as it feels that they have more than a casual relationship with the secondary transactions in these bonds in as much as (i) the banks - particularly foreign banks (either directly or through PMS) - and mutual funds came to have a large stock of these bonds (ii) there is absence of a true market for these bonds (or for that matter, for fixed yielding securities in general) coupled with absence of market making mechanism, which can determine the "market price" to which these can be "marked" in the investors' books or for transactions (iii) the nature and extent of secondary transactions are bound to affect the ability of PSU's to raise bonds in coming years.

2.7 After careful consideration of these aspects, the Committee feels that from now on the PSus should attempt to broad-base the investors in their bonds. For this purpose, the Committee recommends that (i) the terms of the bonds should be market based as in the case of any other companies (it is worth noting that in any case, PSUs paid a higher cost, by way of discounts, etc., even for the existing bonds as mentioned earlier). (ii) the PSUs should market the bonds to a larger section of public investors (without ruling out bulk investors) - this should be possible after satisfying (i) above; (iii) PSus should see that these bonds are listed either on the regular stock market or on the Over the Counter Exchange (OTCEI) and the PSUs should obtain a "rating" before the primary issue and make adequate disclosure in the prospects; (iv) PSUs should build in some comfort regarding liquidity by agreeing to a reasonable buy-back arrangement in the early years as in the case of private sector companies (v) PSUs should reserve a small portion of the issue proceeds for setting up and supporting selected market makers (vi) PSUs should issue the bond certificate expeditiously after the issue.

2.8 The above recommendations are not meant to understate the role of private placement with bulk investors, which would continue to grow in future especially with the expected establishment of new mutual funds and asset management companies as also availability of larger proportion of discretionary funds with banks with phased reduction in SLR. The main point is to make available even for these investors a liquidity or an exit route without having to wait for final maturity despite changes in the interest rates in the interim.

2.9 The Committee also recommends that the issue of tax-free bonds should be reviewed so that interest rate distortions that they produce are avoided. It should be noted that no efficient market for these bonds can be created as perception regarding yield varies according to the level of marginal tax rate of the seller/purchaser.

<u>Units</u>

2.10 Presently, there are mutual funds (fund schemes) floated by Unit Trust of India (UTI), SBI Mutual Fund, Canbank Mutual Fund, LIC Mutual Fund, GIC Mutual Fund, Indian Bank Mutual Fund, Bank of India Mutual Fund, PNB Mutual Fund which in total, amounted to Rs.37,750 crores as of June 1992. Of these only a few are open ended schemes where the liquidity is provided by the mutual fund itself, by announcing sale and purchase prices. Of the closed ended schemes not all are listed on the stock exchange. Good examples of freely traded closed ended units are mastershares of UTI where regular quotations are available on stock exchange.

2.11 Mutual funds can be expected to grow substantially in coming years as they are getting increasingly popular as providers of savings instruments that give comfort as to yield, liquidity, participation in growth and relative safety. Private sector, which is expected to make an entry into this field can also be expected to strengthen this trend.

2.12 The Committee whilst enquiring about transactions in units, noted that largest number and quantum of deals transacted are by far the largest in the case of 1964 Scheme of UTI. It is noteworthy that a regular market has emerged in the case of 1964 UTI units, despite it being an open-ended scheme with sales/purchase possibility being provided by UTI. The prices announced by UTI are not based on the net asset value of the Fund but are based on the expected yield for the year, and the months to go before the close of the accounting year. The 1964 Unit scheme of UTI is not intended to be a "growth scheme".

2.13 This market operates on much thinner margins than the difference between the sale and repurchase prices quoted by UTI. Of course, the operators in the market derive comfort from the ultimate liquidity provided by UTI.

2.14 It should be noted that this market deals only with large individual sales and purchases. In fact, as in the case of PSU bonds, the entire issue concerning the 1964 units of UTI relates to the large/bulk investors like corporate entities including private sector companies and PSUs having surplus liquidity, banks and financial institutions.

2.15 In this context, it should be noted that at the end of June 1992, about 76% of the total funds in 1964 scheme of UTI belong to the corporate sector. One of the main factors is the benefit under section 80M of the Income Tax Act, which only income under this scheme enjoys. A lesser reason is the guidelines stipulated by the erstwhile Controller of Capital Issues regarding interim utilisation of debenture proceeds raised by companies in units amongst others before they are deployed towards final purpose.

2.16 The Committee notes that while the logic of the 1964 scheme addressed individual investors, the contribution of corporate sector now forms a major part of its corpus despite substantial volatility noticed in the corporate inflow and outflow of funds from that source during certain months. In the last two years, however, the net contribution of corporate funds to US 64 scheme has been negative. The continuation and success of US 64 scheme, therefore, would not appear to be dependent on corporate contributions to the Scheme.

2.17 The Committee recommends that UTI, however, should look into whether it is appropriate that corporate investors who have entirely different investment criteria and needs should be accommodated in the same scheme as individual investors or whether the former should have a separate scheme.

2.18 The Committee considered whether the market that presently exists in the 1964 units of UTI has any raison d'etre in the context of sale/purchase facility provided by UTI under the very principle of an open ended scheme. Since the secondary market in units has served a useful purpose over the years, there is no harm in allowing such a market to continue as it provides one more money market instrument.

2.19 While supporting the continuation of this market, the Committee noted that these deals are put through by brokers who are recognised members of the (mainly Bombay) Stock Exchanges. The 1964 units of UTI are not listed and hence, cannot be dealt with by members of a stock exchange as the rules prevent them to do so unless they obtain permission from the stock exchange authorities. Our enquiries indicate that no such formal approval has been granted nor attention been paid to regulation of this market. The Committee recommends that the secondary market of unlisted 1964 Units should be regulated by SEBI/Stock Exchange authorities under its bye-laws and rules as the case may be.

Market for Fixed-yielding Securities

2.20 Looking at the above mentioned background, the Committee strongly feels that there is a need for establishing and fostering an open market for PSU bonds and for that matter for all fixed yielding securities where transactions can be put through in a transparent manner and reliable market prices of these instruments can emerge for use in valuation of investors' assets and as indicators of market expectations in case of terms for future issues.

2.21 The Committee deems it necessary to increase the depth of the market by bringing in progressively higher proportion of individual investors. It is in this context the Committee considers it advisable to get the PSU bonds listed on the Stock Exchanges. The exchanges should promote a floor for PSU bonds and make it worthwhile for PSUs to list the bonds.

2.22 While such a market would deal in listed securities and securities listed in future, the Committee notes that many of the existing PSU bonds are privately placed. It is for consideration of SEBI whether these should be allowed to be traded on the regular stock exchanges. The Committee recommends that PSU's should list their existing bond issues on the Stock Exchanges, and SEBI/Government of India should relax the listing requirements appropriately to enable this expeditiously.

2.23 Bombay Stock Exchange for instance has expressed its willingness to provide separate space and facilities for the purpose and also agreed to review and reduce the listing fee.

2.24 The proposed National Stock Exchange can provide a fillip to the trading in PSU bonds as it will have an electronic floor networking throughout India exclusively for debt instruments and the Institutions are expected to act as market makers.

2.25 The Committee noted that such a market may serve the large/bulk investors, whose role will continue to be important. With the terms of fixed yielding securities getting fixed on realistic market expectations, the investor base for these securities will broaden as well as deepen.

2.26 The Committee, therefore, recommends that RBI and SEBI should see that the Stock Exchanges implement the proposal to create a special trading facility debt instruments and that while planning the National Stock Exchange, provision is also made for transacting fixed-yielding securities. The relationship of the market with the proposed clearing system is dealt with in chapter IV.

2.27 The Committee is aware that a market for such securities can function efficiently only through market makers who can quote sale/purchase prices within a reasonable spread. The

Committee recommends that RBI should encourage a few large players in this field to become market makers. It will be necessary for those market makers to be provided access to funds at appropriate rates.

CHAPTER III

TRANSACTIONS IN PSU BONDS AND UNITS

3.1 In examining the deficiencies of the existing trading procedures for PSU Bonds and Units, the Committee observed that these large and frequent transactions in PSU Bonds and Units had the following characteristics :

(i) Many of the transactions were of re-purchase type (REPO also known as ready forward transactions) and

(ii) Most of the transactions were covered by Banker's Receipt (BR) instead of physical delivery of concerned scrips, let alone transfer in the name of the purchaser in the books of primary issuer.

Ready Purchase Transactions

3.2 It is worthwhile noting that the system of REPO is in fact not a sale/purchase deal at all; it is a money market device for borrowing and lending short term funds against lending and borrowing of assets. It is also a method by which a dealer can obtain short term funds for financing his stock of investments.

3.3 Use of REPO in bonds as a money market instrument is fast expanding in most of the developed financial systems. In the United States, the daily outstandings of such transactions are estimated to be anywhere between US$ 50 billion to US$ 125 billion. While most of the REPO trade is carried out in government debt, it is also transacted in floating rate notes and fixed rate Euro bonds. France also has an extremely active domestic REPO market called the re'me're' market (recently renamed pensions livere'es). The French domestic market equals the combined outstandings of all international sectors. The players - US, European as well as Japanese - in this market are investment banks, security houses as well as banks (ref. Euromoney, June 1991, pages 38-44).

3.4 In India too, REPO operations between banks/institutions have been in vogue for quite some time mainly in government securities as these assets are "lent" or "borrowed" for fulfilling SLR requirements. After 1985-86, they got extended to PSU bonds as in the absence of a market, the banks (which had large stocks of them) could generate liquidity only through REPO operations. At the same time, in the absence of a liquid market in PSU bonds and alternative money market instruments, investors of temporary surpluses required repurchase facility to eliminate risks of capital losses. The same thing happened in units, which banks/institutions invested in mainly to obtain 80M benefit which require transfer in the investor's name only in June. For the rest of the period, the stocks of units got used as an underlying security for money market transactions.

3.5 The Committee understands that a number of public sector units, private sector corporate units, trusts and other bodies which have surplus funds place them with the banks and their subsidiaries. While accepting these funds, although no specific levels of returns are assured, generally they offer attractive returns on such funds. These fund management bodies generally trade in PSU bonds, units of Unit Trust of India, treasury bills and other Government securities for generating profits.

3.6 RBI, in its circular dated April 15, 1987, has directed the banks that they should not enter into repurchase transactions in respect of their holdings of public sector bonds. Subsequently in December 1987 RBI further directed the banks that they should not enter into repurchase transactions in units of UTI. Presently RBI allows REPOs only in treasury bills, which are issues for 182/364 days. The outstanding amount of the treasury bills is presently small, but is likely to grow substantially.

3.7 REPO transactions provide considerable scope for arbitrage transactions, where if one of the parties to the deal does not have the physical security in custody the arbitrageur is exposed to credit risk. The erstwhile system of REPOs suffers from the deficiency that at times there could have been mismatch of transactions in the absence of a centralised agency to which the transactions are reported by all parties for matching and settlements.

3.8 In a number of REPO transactions, brokers are involved and they may be taking positions. As mentioned in the

Janakiraman Committee Report, there have been many transactions without a bank being present in the second leg. The current RBI guidelines also do not permit lending of money to the brokers in any form for stock market operations and REPOs were unauthorisedly utilised as a veneer for covering provision of interim financing to brokers for their transactions in shares in a booming market.

3.9 Despite the above noted deficiencies in the REPO transactions, the Committee feels that it would be counterproductive to ban these types of transactions forever as they serve a useful purpose as money market instrument for equilibrating liquidity and for covering needs of banks and bulk investors for short-term funds at varying points of time. Perhaps, after the SLR levels are brought down to reasonable levels, the need for such REPOs amongst banks may wane. The Committee notes that in a recent interview the Finance Minister has stated that "Over a period of time we will certainly decrease the statutory liquidity ratio......in three to five years we can reach our targets so that Banks will have more money to lend at attractive rates of interest and their incentive to cut corners to show profitability, will diminish." (Refer India Today July 31, 1992 page 69.)

3.10 Till then, however, there is a case for their continuation. The Committee while recommending their continuation - even in PSU bonds and units - would like to stress that the transactions should be covered by prudential guidelines to be stipulated by RBI limiting overall maximum position as also portfolio turnover ratio per player and stipulation that all transactions are put through a centralised clearance system (as detailed in the next chapter), which can inter alia make the necessary information available to the authorities. The REPOs in PSU bonds (of which bulk investors have large stocks) will ensure liquidity in these securities. This will also facilitate new issues of PSU bonds.

3.11 Connected with REPOs is the issue regarding the accounting of these securities in the books of the banks/financial institutions. The Committee feels that RBI may ensure that these are valued at market prices rather than at prices nominated in REPO transactions.

3.12 The Committee recommends that only banks, mutual funds and financial institutions are allowed to participate in the REPO operations. These also would necessarily be the members of the centralised clearing agency. The need of some of the PSUs who have large stocks of existing PSU bonds also has to be recognised and they should be allowed to participate in REPO transactions with banks/mutual funds/financial institutions for a limited period of say, two years.

3.13 As regards role of brokers, the Committee recommends that the firms dealing in the money market transactions should be segregated from those dealing in shares. RBI would be the right authority to regulate such firms with regard to adequacy of their capital, extent of transactions etc. These brokers should not be allowed to take positions, but they should act as genuine intermediaries.

<u>Bank Receipts</u>

3.14 Most of the REPO transactions are carried through issue of BRs. Often the issue of BRs becomes inevitable for entering into such transactions. Firstly, physical delivery of scrips in such short term transactions becomes difficult as the volume of scrips to be delivered is very large. As the delivery involves verification of the securities, the delivery process becomes extremely cumbersome and time consuming. In a number of instances, it was noted that the PSUs had not issued bond certificates for long periods and as a result, the document available with the investors is only in the form of allotment letter. In such cases also, BR has been found to be a convenient mode for concluding the transaction. There were also instances where the investors did not have the required denominations of bond certificates while the transactions concluded related to part of the single allotment of the scrips. In all such cases, the issuance of BR became a necessity.

3.15 The deficiencies in covering the transactions by BRs were not so much because of their inherent deficiency, but because of the imprudent manner in which they were used.

As mentioned in the foregoing paragraph many of the transactions did require use of BRs in the absence of an alternative system. The Committee has later (see next chapter) recommended establishment of a depository and an electronic book-entry type system, which would eventually eliminate the need for BRs and hence, their misuse. However, establishment of such a system will require time because of need for audit of existing stocks of securities, matching and squaring of outstanding transactions, solution being found for tackling the question of stamp duty for transfers to the depository, training of staff, installation of telecom network and development of software. This may call for some legislation also (which as the Committee understands is under consideration). In the meantime, use of BRs may have to be permitted with suitable safeguards so that the earlier recommendation of continuation of transactions in PSU bonds and units can be implemented.

3.16 In the light of suggestions made by Janakiraman Committee Report, the Committee makes the following recommendations for removing deficiencies in the issuance of BRs which facilitates REPO transactions. The BR should be as per the format stipulated by the Indian Banks Association. It should indicate the date by which the transactions through delivery of scrips would be completed or the transaction is squared up. The BR should not have a maturity of more than three months. There should be a stock register of securities in which the corresponding issue of BRs is appropriately marked against the distinctive numbers. In case of the BR issued on the security of allotment letter or that its issue due to non-availability of required denomination of the security, details of the allotment letter as also the distinctive number of jumbo scrip together with its face value should be indicated in the BR. Organisations issuing the BR should maintain full record of BRs issued by it and also should allot continuing serial number for the BR.

3.17 The Committee recommends that RBI should lay down limits per organisation regarding the outstanding amount of BR that it can have at any point of time. This dovetails with the Committee's earlier recommendation regarding limits on REPOs.

3.18 There should be internal audit certifying that the transactions are as per the guidelines and within credit limits approved by the RBI. Such internal audit reports highlighting exceptions should be submitted to the RBI every month. Even though the payment and delivery of BRs directly takes place between the concerned players trade for trade, each player should be required to report to ECSD (see later paragraph on organisation) who would match trades and also report unmatched trades to RBI for further action. This agency should also keep track of the transaction limits and the turnover. The agency should also monitor as to whether reported transactions have been reversed on the due dates of maturity.

CHAPTER IV

CLEARANCE AND SETTLEMENT SYSTEM FOR PSU BONDS

4.1 The Committee has carefully examined the existing procedures of transactions of PSU bonds and units amongst bulk investors and considered the deficiencies as described in chapter III. The Committee also has taken note of the fact that most of these transactions are in the nature of money market operations. Such operations take place mainly in Bombay. The Committee has also kept in view the criteria/objectives that it had placed before itself as listed in chapter I.

4.2 Considering all the above factors, the Committee recommends that all the transactions be routed through a Centralised Agency which will operate an electronic book-entry clearance and settlement system and would also act as Depository (ECSD). The Committee further recommends that RBI ensures that all the bulk investors (i.e. banks, mutual funds financial institutions and PSUs) become members of the ECSD and all their transactions in PSU bonds/units irrespective of whether they are traded on Stock Exchanges or outside on Spot basis, are reported, cleared and settled through ECSD.

4.3 The Committee recommends that there be only one ECSD in Bombay/New Bombay as fractionating into many smaller organisations may not be cost effective and may create problems in monitoring and control. Annexure III gives details regarding operations of an ECSD.

4.4 The Committee is aware that the book entry only' system is substantial departure from the present paper based system of transfer form or physical delivery of documents such as BRs and legal sanction will be necessary for recognising such transfers.

4.5 The payment of stamp duty as presently payable on transfer deeds will not be feasible in the case of book entry transfers unless an alternative method is introduced for sourcing the revenue on the basis of the point of time when the legal interest passes. In the case of existing PSU bonds, the question of stamp duty may not arise as they are transferable by endorsement and delivery.

4.6 To give a legal standing to the Depository, legal changes would also be required for registration of PSU bonds and units in the name of the Depository. Legal change will also be required for exemption of revenue/stamp duty in respect of PSU bonds/units whilst registering in the name of the depository.

4.7 The Committee recognises that to achieve all the above steps as also for completing the audit and the reconciliation of the holdings and the liquidation of BRs, it would take, may be, six months. This time can also be utilised for taking administrative steps such as providing space for ECSD, establishing electronic hardware and software, and training of manpower. While all the abovementioned preparatory steps are being taken, ECSD should be formed and become operative straightaway even in limited fashion so that it can act as a centralised agency for monitoring the transactions and making the data available for monetary and regulatory authorities.

<u>Phase I</u>

4.8 During this preparatory phase, the Committee recommends that transactions are allowed through the mechanism of BRs albeit with all the safeguards regarding form of BRs, maximum positions and turnover as mentioned in chapter III. Trading and settlement will continue as at present. Trades will be reported to ECSD for matching which will monitor and inform monetary and regulatory authorities in totality or of deviations in guidelines.

<u>Phase II</u>

4.9 After the first six months mentioned above, the PSU bonds/units held by the members of ECSD will be returned to the primary issuer based on audit referred to earlier and thus primary issuers will issue a confirmatory statement that they are holding the same in the name of ECSD. In this phase, ECSD will be in a position to clear settle and register book entry transfers. It is assumed that legislation as mentioned in the foregoing paragraphs will be in place by then. In case there is a slippage on passing the legislation, alternative of ECSD acting on an Agency basis can also be considered, although in the Committee's view, this method is not altogether satisfactory. In this phase, ECSD will be in a position to provide each member a daily statement of transactions and net positions as also the rejected transactions. Within 24 hours after the trade, ECSD will also supply statements to the regulatory and monetary authority either in totality or on exception basis highlighting breach of guidelines.

4.10 In the foregoing phases I & II, the ECSD is expected to do matching of transactions. It is conceivable that because of the small number of players involved, matching can be achieved by the trade being authenticated by both the parties on the trading document.

Phase III

4.11 In the third phase, i.e.within one year of the preparatory phase, ECSD will be in a position to put through the transactions on electronic network basis without use of paper for trade reporting. In this phase, it may also be possible to consider dovetailing the work of ECSD within the proposed National Clearance and Depository System.

Organisation

4.12 The Committee carefully reviewed the organisation structure for successful implementation of the proposed strategy for clearance and settlement. The Committee feels that the proposed organisation should have track record for the implementation of the information technology, familiarity with secondary market operations, and the most important, trained manpower with knowledge base and conceptual skills. The Committee observes that the Stock Holding Corporation of India Ltd. (SHCIL) has trained manpower with adequate knowhow to act as a depository and a clearing organisation. The Committee, therefore, recommends that the SHCIL may be entrusted with the task of promoting the depository clearing and settlement mechanism and the introduction of an electronic book entry transaction system for PSU bonds and units.

CHAPTER V

RECOMMENDATIONS

The Committee's recommendations appear spread through the Report alongwith discussions on the concerned issues. These recommendations are brought together and summarised in this chapter. The Committee recommends that :-

Terms of Issue of PSU bonds

1. (i) The terms of the PSU bonds should be market based as in the case of any other companies. (ii) The PSUs should market the bonds to a larger section of public investors (without ruling out bulk investors) - this should be possible after satisfying (i) above; (iii) PSus should see that these bonds are listed either on the regular stock market or on the Over the Counter Exchange (OTCEI) and the PSUs should obtain a "rating" before the primary issue and make adequate disclosure in the prospectus;(iv) PSUs should build in some comfort regarding liquidity by agreeing to a reasonable buy-back arrangement in the early years as in the case of private sector companies (v) PSUs should reserve a small portion of the issue proceeds for setting up and supporting selected market makers (vi) PSUs should issue the bond certificate expeditiously after the issue (see 2.7).

2. Issue of tax-free bonds should be reviewed so that interest rate distortions that they produce are avoided (see 2.9).

<u>Secondary Market for PSU bonds</u>

3. There is a need for establishing and fostering an open market for PSU bonds and for that matter for all fixed yielding securities where transactions can be put through in a transparent manner and reliable market prices of these instruments can emerge for use in valuation of investors' assets and as indicators of market expectations in case of terms for future issues (see 2.20).

4. It is advisable to get the PSU bonds listed on the Stock Exchanges. The Exchanges should promote a floor for PSU bonds and make it worthwhile for PSUs to list the bonds (see 2.21). RBI and SEBI should see that the Stock Exchanges implement the proposal to create a debt floor and that while planning the National Stock Exchange, provision is also made for transacting fixed-yielding securities (see 2.26).

5. While such a market (recommendation 3) would deal in listed securities and securities listed in future, the Committee notes that many of the existing PSU bonds are privately placed. It is for consideration of SEBI whether these should be allowed to be traded on the regular stock exchanges. The Committee recommends that PSU's should list their existing bond issues on the Stock Exchanges, and SEBI/Government of India should relax the listing requirements appropriately to enable this expeditiously (see 2.22).

6. RBI should encourage two or three large players in this field to become market makers. It will be necessary for those market makers to be provided access to funds at appropriate rates (see 2.27).

1964 Unit Scheme

7. UTI should look into whether it is appropriate that corporate investors who have entirely different investment criteria and needs should be accommodated in the same scheme as individual investors or whether the former should have a separate scheme (see 2.17).

8. Since the secondary market in units has served a useful purpose over the years, there is no harm in allowing ~~such~~ a market to continue as it provides one more money market instrument (see 2.18).

9. The secondary market in unlisted Units should be regulated by SEBI/Stock Exchange Authorities under its bye-laws and rules as the case may be (see 2.19).

Ready Purchase Operations

10. It would be counterproductive to ban REPO transactions as they serve a useful purpose as money market instrument for equilibrating liquidity and for covering needs of banks and bulk investors for short-term funds at varying points of time (see 3.9).

11. While continuation of REPOs even in PSU bonds and units could be allowed, it is important that the transactions should be covered by prudential guidelines to be stipulated by RBI limiting overall maximum position as also portfolio turnover ratios per player and stipulation that all transactions are put through a centralised clearance system, which can inter alia make the necessary information available to the authorities (see 3.10).

12. Only banks, mutual funds and financial institutions may be allowed to participate in the REPO operations. These also would necessarily be the members of the centralised clearing agency. The need of some of the PSUs who have large stocks of existing PSU bonds also has to be recognised and they should be allowed to participate in REPO transactions with banks/mutual funds/financial institutions for a limited period of say, two years (see 3.12).

13. RBI may look into the manner in which banks and financial institutions account in their books their investments in PSU bonds and units and ensure that these are valued at market prices rather than at prices nominated in REPO transactions (see 3.11).

<u>Role of Brokers</u>

14. As regards role of brokers, the Committee recommends that the firms dealing in the money market transactions should be segregated from those dealing in shares. RBI would be

the right authority to regulate such firms with regard to adequacy of their capital, extent of transactions etc. These brokers should not be allowed to take positions, but they should act as genuine intermediaries (see 3.13).

<u>Phased Electronic Clearance, Settlement and Depository (ECSD)</u>

15. All the transactions should be routed through a Centralised Agency which will operate an electronic book-entry clearance and settlement system and would also act as Depository (ECSD). RBI should ensure that all the bulk investors (i.e. banks, mutual funds, financial institutions and PSUs) become members of the ECSD and all their transactions in PSU bonds/units irrespective of whether they are traded on Stock Exchanges or outside on Spot basis, are reported, cleared and settled through ECSD (see 4.2).

16. There be only one ECSD in Bombay/New Bombay as fractionating into many smaller organisations may not be cost effective and may create problems in monitoring and control (see 4.3).

17. To give a legal standing to the Depository, legal changes would also be required for registration of PSU bonds and units in the name of the Depository. Legal change will also be required for exemption of revenue/stamp duty in respect of PSU bonds/units whilst registering in the name of the depository (see 4.[illegible]).

18. ECSD should be formed and become operative straightaway (without waiting for completion of infrastructure and passing of legislation) even in a limited fashion so that it can act as a centralised agency for monitoring the transactions and making the data available for monetary and regulatory authorities (see 4.7).

Phased Development of ECSD

19. During this preparatory phase I, transactions will be allowed through the mechanism of BRs albeit with all the safeguards regarding form of BRs, maximum positions and turnover, etc. Trading and settlement will continue as at present. Trades will be reported to ECSD for matching which will monitor and inform monetary and regulatory authorities in totality or of deviations in guidelines (see 4.8).

20. The BR to be used during this interim period should be as per the format stipulated by the Indian Banks Association. It should indicate the date by which the transactions through delivery of scrips would be completed. The BR should not have a maturity of more than three months. There should be a stock register of securities in which the corresponding issue of BRs is appropriately marked against the distinctive numbers. In case of the BR issued on the security of allotment letter or that its issue due to non-availability of required denomination of the security, details of the allotment letter as also the distinctive number of jumbo scrip together with its face value should

be indicated in the BR. Organisations issuing the BR should maintain full record of BRs issued by it and also should allot continuing serial number for the BR (see 3.16). During this period, RBI should lay down limits per organisation regarding the outstanding amount of BR that it can have at any point of time. This dovetails with the Committee's earlier recommendation regarding limits on REPOs (see 3.17). There should be internal audit certifying that transactions are as per the guidelines and within limits approved by RBI. Such monthly internal audit reports highlighting exceptions should be submitted to RBI (see 3.18).

21. In phase II, after the first six months mentioned above, BRs will be liquidated and PSU bonds/units held by the members of ECSD will be returned to the primary issuer and primary issuers will issue a confirmatory statement that they are holding the same in the name of ECSD. In this phase, ECSD will be in a position to clear settle and register book entry transfers (see 4.9).

22. In the third phase, i.e. within one year of the preparatory phase, ECSD will put through the transactions on electronic network basis without use of paper for trade reporting (see 4.11).

<u>Organisation</u>

23. The SHCIL may be entrusted with the task of promoting the depository clearing and settlement mechanism and the introduction of an electronic book entry transaction system for PSU bonds and units (see 4.12).

S.S. Nadkarni
Chairman

S.A. Dave

Bansi S. Mehta

Kamal Pande

V. Mahadevan

N.S. Saraf

Pratip Kar

R. Chandrasekaran
Member-Secretary

Bombay
August 7, 1992.

ANNEXURE - I

RESERVE BANK OF INDIA
CENTRAL OFFICE
BOMBAY

June 9, 1992

Jyaistha 19, 1914(Saka)

MEMORANDUM

Committee on Trading in Public Sector Bonds and Units of Mutual Funds

In pursuance of a recommendation by the Committee to Inquire into the Securities Transactions of Banks and Financial Institutions, it has been decided to set up a Committee to evolve an improved procedure for conducting transactions in public sector bonds and units of mutual funds. The terms of reference of the Committee will be as follows:

(a) To critically examine the existing trading procedures relating to transactions in public sector bonds and units of mutual funds.

(b) To recommend improvement in these procedures with a view to eliminating the deficiencies in the existing procedures, including the system of issuance of bankers receipts.

(c) To recommend the modalities of an alternative specialised system of booking transactions and the evolving of efficient methods of accounting and transfers.

(d) To make recommendations on such other matters as the Committee deems appropriate.

The members of the Committee will be :

1.	Shri S.S. Nadkarni Chairman Industrial Development Bank of India	Chairman
2.	Dr. S.A. Dave Chairman Unit Trust of India	Member
3.	Shri V. Mahadevan Managing Director State Bank of India	Member
4.	Shri W.S. Saraf Executive Director Reserve Bank of India	Member
5.	Shri Bansi S. Mehta Chartered Accountant Senior Partner Bansi Mehta & Co.	Member
6.	Representative of Department of Economic Affairs Ministry of Finance Government of India	Member
7.	Representative of Securities & Exchange Board of India	Member
8.	Shri R. Chandrashekaran Managing Director Stock Holding Corporation of India Ltd.	Member-Secretary

The Committee may co-opt such other persons as may be appropriate.

The Committee may submit its report by the end of July 1992.

S. Venkitaramanan

(S. Venkitaramanan)
Governor

ANNEXURE II

MEETINGS HELD WITH VARIOUS GROUPS IN CONNECTION WITH THE COMMITTEE FOR TRADING IN PUBLIC SECTOR BONDS AND UNITS OF MUTUAL FUNDS

1) FOREIGN BANKS

Mr. Girija Pande General Manager (Investment Banking)	ANZ Grindlays
Mr. Vishnu Deuskar Chief Manager (Investment Banking)	ANZ Grindlays
Mr. A. Agarwal Vice President - Country Treasurer	Bank of America
Mr. A.S. Thiyagarajan Vice President	Citibank NA
Mr. Gunit Chadha Vice President	Citibank NA
Mr. Kiran Umrootkar Head - Treasury	Standard Chartered Bank
Mr. M. Rane Financial Institutions Officer	Standard Chartered Bank
Shri G. C. Dobby Chief Executive Officer	The Hongkong & Shanghai Banking Corporation Limited
Shri P. Panjwani Financial Consultant	The Hongkong & Shanghai Banking Corporation Limited
Shri K. Sinha Area Financial Controller	The Hongkong & Shanghai Banking Corporation Limited

(2) BROKING FIRMS

Mr. Shahurat Belapunthu	Asit C. Mehta
Mr. Asit Mehta	Asit C. Mehta
Mr. M. Murarka	Batlivala & Karani
Mr. Hemendra Kothari	D.S. Purbhodas & Co.
Mr. Sanjiv Shah	D.S. Purbhodas & Co.
Mr. Nimesh Kampani	J.M. Share & Stock Brokers Ltd.
Ms. Anahaita Shah	J.M. Share & Stock Brokers Ltd.
Ms. Radhika Haribhabh	J.M. Share & Stock Brokers Ltd.

(3) MUTUAL FUNDS

Mr. Sharad Dave Executive Trustee	Bank of India Mutual Fund
Mr. Suhas Kulkarni Manager (Investment)	Bank of India Mutual Fund
Mr. K.R. Acharya Chief Executive	Canbank Mutual Fund
Mr. K.V. Hegde Dy. Chief Executive	Canbank Mutual Fund
Mr. C.S. Goplakrishna General Manager	Canbank Mutual Fund
Mr. K.N. Kamath Managing Director	Canbank Financial Services
Mr. S.K. Mitra Chief Executive	GIC Mutual Fund

Mr. R.F. Jetha Group Head (Market Ops)	GIC Mutual Fund
Mr. S.M. Subramanian President	Indian Bank Mutual Fund
Mr. U.R. Bhat Executive Vice President	Indian Bank Mutual Fund
Mr. P.K. Pandit Executive Trustee	LIC Mutual Fund
Mr. V. Narayanan General Manager (Fin)	LIC Mutual Fund
Mr. R. Murlidharan	PNB Capital Market
Mr. Joginder Bajaj	PNB Mutual Fund
Mr. N. Sriram General Manager	SBI Mutual Fund
Mr. B. Rai Managing Director	SBI Funds Management Co. Ltd.
Mr. R. Viswanathan Managing Director	SBI Capital Markets Ltd.

(4) NATIONALISED BANKS

Mr. C.B. Ramamurthy General Manager	Bank of Baroda
Mr. D.N. Upadhye Asst. General Manager	Bank of India
Mr. S. Shanbhag Divisional Manager	Canara Bank
Mr. V. Manoharan Asst. General Manager	Canara Bank
Mr. N.K. Venkateshwara Dy. General Manager	Central Bank of India

Mr. V.R. Veerappan General Manager	Indian Overseas Bank
Mr. S.A. Kamath Executive Director	Union Bank of India
Mr. M.S. Mohan Asst. General Manager	Union Bank of India

(5) PUBLIC SECTOR UNITS

Mr. V.S. Jain General Manger (Fin)	Indian Oil Corporation
Mr. V.K. Chawla General Manager (Fin)	Indian Oil Corporation
Mr. K.K. Agarwal General Manager (Capital Issue)	Mahanagar Telephone Nigam Ltd. New Delhi
Mr. K.J. Sebastian General Manager (Fin)	National Power Corporation
Mr. C.K. Koshy Executive Director	National Power Corporation
Mr. M.C. Nawalkha Member (Fin)	National Power Corporation
Mr. C.P. Jain Executive Director (Fin)	Nuclear Thermal Power Corporation
Mr. R.K. Sharma Senior Manager (Bonds)	Nuclear Thermal Power Corporation

(6) Mr. G.V. Ramakrishna, Chairman,
Securities & Exchange Board of India

(7) Mr. Cyril Shroff, Partner,
Amarchand & Mangaldas & Hiralal Shroff & Co.

(8) Mr. Govind Desai, President
and Mr. M.R. Mayya, Executive Director,
Bombay Stock Exchange

(9) MEMBERS OF JANAKIRAMAN COMMITTEE

Shri R. Janakiraman
Dy. Governor
Reserve Bank of India

Shri C.P. Ramaswamy
Dy. Director of Income Tax

Shri E.N. Renison
Retd. Additional Director, CBI

Shri Y.H. Malegam
Sr. Partner
S.B. Billimoria & Co.

Shri V.G. Hegde
Principal Legal Officer
Reserve Bank of India

Shri N.D. Parmeswaran
Chief Officer (DBOD)
Reserve Bank of India

Kum. V. Vishwanathan
Executive Director
Reserve Bank of India
Member - Secretary

(10) RESERVE BANK OF INDIA
Department of Statistical
Analysis & Computer Services

Smt. Rama Ananthakrishnan
Director

Shri M. A. Khan
Assistant Adviser

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ANNEXURE III

Trading and clearance system for units and PSU bonds

Contents

Sub: <u>Trading and clearance system for units and PSU bonds</u>

1. Introduction :

This preliminary concept paper outlines an Electronic book entry systems solution for trading, Clearance, Settlement, Custody and transfer of public sector bonds and units, which hereafter shall be termed as ECSD.

2.0 Objectives :

2.1 The major objectives of the proposed system are as follows :

a. The system should provide for transparency in trading and for matching of sale and buy offers.

b. It should provide for efficient and expeditious transfer and settlement.

c. It should provide instant recording of transactions and reconciliations.

d. It should recognise that institutional players will continue to dominate the market for PSU Bonds and units.

e. It should ensure perpetual inventory control of the holdings of the market players.

2.2 <u>Supplementary objectives of the proposed system are</u> :

a. to make "book-entry only" new issues of PSU bonds and units possible at least in respect of institutional subscribers (dematerialisation).

b. to provide up to date on-line information for the players and also the statutory and regulatory authorities.

c. to aim at reducing the cost per transaction in handling all such trades for all the parties involved.

d. to perform sensitivity analysis on computerised book- entry system so as to introduce such facilities for wider range of securities and monetary instruments.

e. to eventually permit trade on an all India basis without any geographical cost and time disadvantages.

3. Trade mechanism :

All market players will be required to become members of the trading system which will enable them to put through the transactions on electronic network without use of paper for recording and reporting the trade. Until the trading system is in place, the existing mechanism of trading in PSU bonds and units will continue.

For the purpose of this system the mechanism of trading in PSU bonds and units will be as described in the main body of the report. Eventually, the system can be enhanced to provide for quote display and electronic trading facilities. This will really mean ringless trading using a central computer.

4. Members :

Initially it is expected that all the members will operate within Bombay. Cross country banks and other institutions will be expected to have a Bombay agent to take part in trade reporting, clearance and settlement. Extensions to other cities will be implemented in phases, after successful implementation of the system at Bombay.

5. Trade reporting :

(a) When the existing trading mechanism is continued :
The members will report the trade to ECSD before 4 p.m. on each trading day. The trade can be reported through floppy medium. Facilities will also be provided for the medium of paper as an interim measure. Members will also be expected to automate their function. The format for reporting the trade and the batch controls that are required for detecting duplicates and missing numbers etc. will be standardised by ECSD . These standards will be uniformly applicable for all members.

(b) In case the trading is done through an exchange , then the exchange authorities will be responsible for reporting the trades as per specified format with all the controls described above.

6. Instruments for trade :

The system is essentially for PSU bonds and units. Since scripless trade is envisaged, there will be no physical paper that will be used for trading, clearance and settlement. However, trading can be for 'delivery and payment' and Repos.

7. Trade validation :

Trades will be validated for position limits as well as churning ratio.

7.1 For every trade that is reported either as a buy or sell, the system expects the counter party also to report the trade. Both the parties should be authorised members. Buy and sell quantities and rates should also tally. All trades that have not passed through the validation will be treated as null and void. The list of invalid/rejected trades will be supplied to each member. System expects the trades to be reinput as fresh trades. However, this simplistic model may be enhanced later to provide additional capabilities.

7.2 Position limits : The system expects RBI to set a position limit for each member for each trading day. Additional limit can also be set per trade or per security. In case there are additional limits, they will be applied first before applying the "day limit".

7.3 Portfolio Turnover Ratio : RBI may also deem it necessary to fix Portfolio Turnover Ratio for each member. In case the total trading per day exceeds this limit, such trades will also be rejected as null and void and such trades will not be taken for clearance and settlement.

8. Arrangement for money account book keeping :

8.1 All members will be expected to open accounts with a neutral bank. As per the recommendation of the Price Waterhouse, Consultants to Stock Holding Corporation of India Limited, on creation of a National clearance and depository system for the country, RBI is well suited to play the roll of the neutral bank. ECSD will be permitted to move the funds across these accounts by electronic instructions. Until electronic funds transfer becomes possible ECSD may instruct the fund transfer through a magnetic floppy disc.

8.2 There are two options :-

Option (i) In this option the members are expected to keep certain minimum balances in their accounts with the neutral bank. As long as the net payment position for the member is not in excess of the limit, the system will accept such trades and process it on for settlement on T + 1 (i.e. on one day after the trade day)

Neutral bank will make provision to debit or credit the accounts of the members as per the statement given by ECSD on the morning of T+1. Neutral bank will also ensure that the members replenish their credit balance as required within the day. Neutral bank will also be given a facility to alter the position limits of the members on a daily basis before 4:00 p.m. In case no revision to the limit is advised, the last advised limit will be applied. Any trades by the members beyond the authorised position limits will be rejected.

Option (ii) The system will intimate Neutral bank the debit position for each member on the morning of T + 1; Neutral bank will confirm the funds availability on evening of T + 1 before 4:00 p.m. after making the required debits. The system will process it for settlement on T + 2 and no new debit advice will be given. If the credit balance is insufficient, such trades will be rejected. All rejected trades to be reinput as fresh ones.

8.3 Initially ECSD will not require the neutral bank to take any responsibility for management of the excess funds in the accounts of the neutral bank. However, some institutions in the developed countries render certain additional services. The neutral bank is authorised to manage the excess funds in these accounts. The profits that are generated are passed on to the account holders after deducting service charges. Such facility may be extended as and when the neutral bank is in a position to render the described services.

9. Clearing and Settlement :

All matched valid trades will be processed for clearance and settlement on the evening of trade day (however in case of option 2 of 8.2 above, the settlement will be on T + 2). All trades will be netted at member / security level and the net delivery or payment position will be worked out. Matched trade details as well as payment / delivery details will be printed, to be disbursed to the members on the morning of T + 1. The system will maintain the net holding position for each security for each member. In case a member does not have adequate holdings for a security to cover the net delivery position, the last in trade will be first rejected. The members will also be given the net holding details alongwith the matched trades statement . When a member has traded within the position limits, and has sufficient holdings to effect the net delivery, the clearing and settlement will be effected on a book entry basis and reported on T + 1.

The ready forward deals (REPOS) will be first given effect on due date before the new trades are taken up for clearing and settlement.

10. Depository Services

Currently, both units and PSU bonds are certificated. Some of the PSU bonds are bearer documents with attached post dated warrants. In respect of units and PSU bonds that require registration, all the certificates will be collected from the respective members and surrendered to Unit Trust of India and the respective public sector units, so that they will act as the custodian until the legislation is passed to give effect to dematerialisation of the scrips.

The Stock Holding and Special Transfer Procedure Act is expected to be passed shortly, by the time the system is ready for implementation. In such a case, the securities will be registered in the nominee's (ECSD) name and dematerialised. The depository services will then be rendered on a book entry basis. In case the Act is not passed by then, suitable alternatives will be considered to make the securities fungible.

11. Benefits disbursement :

Once the Act is passed by the Government, the certificate can be dispensed with and the benefits disbursements done based on the holdings as reflected in the electronic custody account books.

12. Action plan :

12.1 Investigation of existing practice -

This involves :

a) collection of volume and value details for various instruments, members, geographical distribution and time periods.

b) study of the risks that are inherent in the mechanism and how the risks are currently borne by the members.

12.2 Discussions and finalisation of procedures and revised functionalities on various aspects such as risk management, transparency requirements, information for regulatory authorities and the trading, clearance, settlement and depository services. A detailed questionnaire has been prepared which will help in finalisation of these procedures.

12.3 Development of appropriate computer systems :- This will be taken up in phases.

12.3.1 Initially only following functionalities will be provided :

Basic systems for trade reporting, validation, clearing, settlement and reporting. Basic data security aspects will be built in.

12.3.2 Later, modules will be added for full depository services and benefits disbursement including :

a) quote display functions to display the quotes (ask/ bid prices) for various bonds including the interest accrued as on the date of the quotation

b) provision to issue new instruments on the book-entry system

c) range of depository services including lend / borrow/ pledge as required and appropriate

d) MIS.

e) extensive system security, continuous audit, disaster recovery mechanisms

f) networking and remote access by members

g) audit trail and reports to statutory authorities

12.3.3 The appropriate systems for one time master creation as well as capture of audited reconciled holdings will also be developed.

12.4 Project resourcing :

Based on the volume and value details that are collected and the revised functional requirement specifications, the various resources that will be called for in terms of computer hardware, software, networking, manpower, miscellaneous office services will be sized and costed. The tariff for the services to be provided will have to be worked out keeping in mind the one time investment and recurring expenditure including working capital.

12.5 One time master data creation in respect of :

a) one time master data creation of authorised members and details pertaining to them

b) security holdings for each member in each security

c) position limits as appropriate.

13. Time schedule :

Study of existing practices & collection of volume details	Start date + week 4
Finalization of concept after discussion with all concerned parties	+ week 8
System design, presentation and acceptance	+ week 16
System development - basic functionalities (book entry transfers, benefit collection, holding statement)	+ week 26
System development - full functionalities (including electronic trading)	+ week 43
System pilot testing	+ week 47
System tuning and final implementation	+ week 52