IX DEVELOPMENT AND REGULATION OF FINANCIAL MARKETS

9.1 The maintenance of stable and orderly conditions in financial markets assumed priority for the Reserve Bank in 2003-04. Taking advantage of the headroom provided by the comfortable liquidity conditions, the marked improvement in Central Government's finances and somewhat muted demand for banks' non-food credit in the first half of the year, the Reserve Bank carried forward the development of the money, debt and foreign exchange markets over which it has direct regulatory jurisdiction. Satisfactory operation of paperless and straight through settlement of transactions through the Negotiated Dealing System (NDS)/Clearing Corporation of India Limited (CCIL) brought with it significant gains for the functioning of markets. It facilitated speeding up the process of phasing out non-banks from the call/notice money market and simultaneous growth of a buoyant repo market outside the LAF. New modules in the NDS-CCIL system were introduced leading to a switch to the Delivery *versus* Payment (D*v*P) III mode in the Government securities market from April 2, 2004. Measured liberalisation of external transactions was undertaken with a view to adding depth to the foreign exchange market and freeing outflows by resident corporates and individuals. Sensitising market participants to the risks embedded in sudden shifts in market conditions in accordance with global developments remained a concurrent priority.

9.2 Against this backdrop, this Section presents regulatory and developmental aspects of the functioning of the money, debt and foreign exchange markets in 2003-04. In the money market, the focus of the review is on upgradation of the technological infrastructure and various initiatives taken to improve activity including in the emerging segments. The major initiatives in the Government securities market relate to introduction of new instruments and the functional autonomy accorded to market participants. The review of the foreign exchange market underscores the significant liberalisation granted to all classes of participants with a view to deepening the market, while simultaneously improving transparency in an overall move away from micro management of transactions to macro management of flows. Building and upgrading the technological wherewithal for markets is a recurring theme through this Section.

MONEY MARKET

9.3 The Reserve Bank continued to foster balanced development of different segments of the money market. The strategy for market development was characterised by initiatives to introduce new instruments, reduce dependence of participants on uncollateralised exposures, facilitate price discovery in the short-end and upgrade the payment system infrastructure.

Call/Notice Money Market

9.4 The smooth operation of NDS/CCIL enabled progression in the endeavour to develop the call segment as a pure inter-bank market. Exposures of non-banks in the call/notice money market were brought down from 85 per cent of their average daily lendings during 2000-01 to 75 per cent in June 2003, to 60 per cent in December 2003 and further to 45 per cent in June 2004 (Table 9.1). This process was smoothened by the assurance of temporary reprieve from the phase-out in case any non-bank institution faces any genuine difficulty in deploying excess liquidity.

9.5 With effect from February 7, 2004, primary dealers (PDs) were permitted to borrow up to 200 per cent of their net owned funds (NOFs), as at end-March of the preceding financial year, on average, in a reporting fortnight. Any PD facing genuine difficulty in adhering to the limit was permitted to approach the Reserve Bank for extension of period of compliance.

9.6 An endeavour of the Reserve Bank has been to improve transparency in the call/notice money market. Effective the fortnight beginning May 3, 2003, reporting of call/notice money market transactions on the NDS was made mandatory, irrespective of whether executed on the NDS or outside and whether the counterparty is a member of the NDS or not. Necessary changes in the software and dissemination of data to NDS members was executed in July 2003.

9.7 The Reserve Bank had instituted prudential limits of exposure to the call/notice money market for banks from October 2002 keeping in view the potential risk of systemic instability arising out of defaults due to large recourse to the uncollateralised money market segment. Rupee funds raised under the Reciprocal

Table 9.1: Phasing out of Non-banks from the Call/Notice Money Market

Stages	Time Table Announced
1	2
Stage I	Effective May 5, 2001 non-bank institutions (*i.e.*, financial institutions, mutual funds and insurance companies) were allowed to lend up to 85 per cent of average daily call lendings during 2000-01; corporates were allowed to route call transactions through primary dealers up to June 30, 2001.
Stage II	Effective June 14, 2003 the limit of non-bank lendings in the call/notice money market was scaled down to 75 per cent of average daily call lendings during 2000-01.
Stage III	Access of non-banks to the call/notice money market was lowered to 60 per cent of average daily call lendings during 2000-01 effective December 27, 2003 and to 45 per cent with effect from June 26, 2004.

Line Facility were exempted from these limits. This exemption was phased out from the fortnight beginning February 7, 2004.

Certificates of Deposit

9.8 Activity in the Certificates of Deposit (CDs) segment picked up considerably after the issuance of guidelines by the Reserve Bank and the SEBI on investments by banks and mutual funds in non-SLR debt securities, the reduction in stamp duty on CDs effective March 1, 2004 and disallowance of premature closure of CDs *vis-à-vis* alternative competing instruments such as fixed deposits. These developments stimulated demand for investment in CDs by mutual funds, particularly on account of improved funds positions. An encouraging development in this area was rating of CDs by some banks even when such rating is not mandatory under the existing guidelines.

Commercial Paper

9.9 Non-bank entities, including corporates, were allowed during 2003-04 to offer unconditional and irrevocable guarantees for credit enhancement to CP issuances so as to provide flexibility to both issuers and investors. The issuer is required to fulfil the eligibility criteria prescribed for issuance of CP with the guarantor requiring a credit rating of at least one notch higher than that of the issuer from an approved credit rating agency. The offer document for CP needs to disclose the net worth of the guarantor names of the companies to which the guarantor has issued similar guarantees, the extent of the guarantees offered and the conditions under which the guarantee will be invoked. Banks were allowed to invest in CP guaranteed by non-bank entities, provided their exposure remains within the regulatory ceiling for unsecured exposures. Along with the reduction in stamp duty on CP, the recent guidelines by the Reserve Bank on investments in non-SLR securities evinced keen interest from mutual funds for investment in CPs *vis-à-vis* bonds and fixed deposits.

Derivatives

9.10 The Reserve Bank allowed banks and primary dealers to transact in exchange traded interest rate futures in June 2003 in order to make available a wide array of products for banks to hedge their interest rate risk effectively. While PDs were allowed to hold trading as well as hedging positions in Interest Rate Futures (IRFs), banks were allowed only to hedge their underlying Government securities in 'available for sale' (AFS) /'held for trading' (HFT) category portfolio through IRFs. The National Stock Exchange (NSE) introduced futures on a notional 10-year Government security, a 3-month Treasury Bill rate and a 10-year Government zero coupon in June 2003. Activity in the IRF market has not, however, picked up as yet because of valuation problems. Furthermore, the activity in the IRF market was subdued as banks have been allowed only to hedge but not to trade. The Reserve Bank set up an Internal Working Group on Derivatives in September 2003 which recommended, *inter alia*, (i) a harmonisation of regulations between over-the-counter (OTC) interest rate derivatives and exchange traded interest rate derivatives; and (ii) permission to those banks to hold trading positions in IRF market which have adequate internal risk management and control systems and a robust operational framework. The SEBI revisited issues pertaining to introduction of new futures contracts in consultation with the Fixed Income Money Market and Derivatives Association of India (FIMMDA). On January 5, 2004 it permitted trading of interest rate futures contract on an underlying 10-year coupon-bearing notional bond which would be priced on the basis of the yield-to-maturity (YTM) of a basket comprising bonds with maturity ranging from 9 to 11 years.

Collateralised Borrowing and Lending Obligation (CBLO)

9.11 Collateralised Borrowing and Lending Obligation (CBLO) was operationalised as a money market instrument through the CCIL on January 20, 2003. With a view to developing the market for the CBLO, it was exempted from CRR. Furthermore, securities lodged in the gilt accounts of the bank maintained with the CCIL under the Constituents' Subsidiary General Ledger (CSGL) facility and remaining unencumbered at the end of any day can be reckoned for SLR purposes. The wider usage of the instrument is expected to receive impetus from the establishment of real time connectivity between the Public Debt Office (PDO) of the Reserve Bank and the CCIL and value-free transfer of securities between market participants and the CCIL.

Repo Market

9.12 The Reserve Bank has been making efforts to develop the repo market, so as to provide a stable collateralised funding alternative with a view to promoting smooth transformation of the call/notice money market into a pure inter-bank market and for deepening the underlying Government securities market. To broaden the repo market, the Reserve Bank enabled non-banking financial companies, mutual funds, housing finance companies and insurance companies not holding SGL accounts to undertake repo transactions with effect from March 3, 2003. These entities were permitted to access the repo market through their 'gilt accounts' maintained with the custodians. Necessary precautions were built into the system to ensure 'delivery *versus* payment' (D*v*P) and transparency, while restricting the repos to Government securities only. Rollover of repo transactions in Government securities was facilitated with the enabling of D*v*P III mode of settlement in Government securities which involves settlement of securities and funds on a net basis, effective April 2, 2004. This provided significant flexibility to market participants in managing their collateral.

GOVERNMENT SECURITIES MARKET

9.13 The Reserve Bank stepped up efforts to broaden and deepen the Government securities market during 2003-04. Initiatives to promote liquidity in the Government securities market took the form of relaxation of restrictions relating to transactions in the Government securities, introduction of new instruments such as interest rate derivatives to enable participants to hedge market risk and initiation of stricter prudential regulation and surveillance.

Diversification of Instruments

9.14 During 2003-04, the Reserve Bank continued to issue Floating Rate Bonds (FRBs) as an instrument for hedging interest rate risk by investors in the context of elongation of the maturity profile of Government debt in the recent period. During 2003-04, FRBs were issued in three tranches (May 20, August 8 and November 10, 2003) accounting for 16 per cent of the total issuances of dated securities, excluding those issued by way of private placements with the Reserve Bank. The interest rate on these bonds was calculated by adding a fixed spread (determined in the auction) over a variable base rate. With a view to simplifying the price discovery process in the secondary segment of the Government securities market, the design of determining the variable base rate of FRBs was modified with effect from the auction held on May 19, 2003. In terms of the modified design, the base rate was set equal to the average cut-off yield in the preceding three auctions (instead of six) of 364-day Treasury Bills with annual resetting instead of semi-annual. During 2004-05 (up to August 10, 2004), FRBs were issued in three tranches (May 7, July 2, and August 10, 2004) of Rs. 6,000 crore each accounting for 14.4 per cent of budgeted issuances of dated securities.

9.15 Development of the Separate Trading for Registered Interest and Principal of Securities (STRIPS) market received impetus from the steps taken to realign the coupon payment dates with four identified dates so as to create a critical mass for issue of coupon STRIPS. Accordingly, a new security, *viz.*, 6.01 per cent Government Stock 2028 was issued on August 8, 2003 with coupon dates of the new security aligned with the set of coupon payment dates, *viz.*, March 25 and September 25 as identified by the Working Group on STRIPS. The enabling legal provisions for STRIPS will come into effect with the passage of the Government Securities Bill.

9.16 Banks and PDs were permitted to undertake transactions in exchange traded IRFs in June 2003. Operational guidelines were formulated to enable participation of the entities regulated by the Reserve Bank (see Para 9.10 for details).

Trading in Stock Exchanges

9.17 The country wide anonymous, screen-based and order-driven trading in Government securities, which was introduced in stock exchanges (NSE, BSE and OTCEI) in January 2003, continued to register low trading volumes during 2003-04. A Working Group on Screen Based Trading in Government Securities (Chairman: Shri R. H. Patil) was constituted to examine the successful operationalisation of screen-based trading in the NDS as well as the issue of improving liquidity in Government securities trading in the exchanges. Following its recommendations, an anonymous, screen-based, order matching trading system is being incorporated in the NDS. The introductory demonstration was held on August 11, 2004.

Public Debt Office – Negotiated Dealing System

9.18 The LAF module was operationalised on January 13, 2004 in the Reserve Bank's PDO-NDS. LAF auctions were announced by providing all parameters such as issue, duration, type of auctions, opening and closing time. Market participants submit bids within the cut-off time on the system. Members facing genuine systems problems are permitted to submit physical bids. The Treasury Bill auction module was operationalised on October 22, 2003 on the PDO-NDS. The auction is announced and processed on-line in a straight through process (STP) on the system. These two modules are being further fine tuned, encompassing new features and feedback received from market participants.

Sale of Government Securities – New Dispensations

9.19 The Reserve Bank permitted market participants to sell Government securities from April 2, 2004 against confirmed purchase contracts, provided the previous purchase contracts were either guaranteed by the CCIL or have the Reserve Bank as the counterparty. A sale transaction would be settled either in the same settlement cycle as the preceding purchase contract or in a subsequent settlement cycle so that the delivery obligation under the sale contract is met from the securities acquired under the purchase contract. This dispensation would not only reduce the market risk of participants but also facilitate rollover of repos. It was operationalised by switching over to the D*v*P III mode of settlement of Government securities transactions under which securities are settled on a net basis (as against gross basis under the D*v*P II mode).

Primary Dealers

9.20 The primary dealer system has been introduced in a number of countries with the objective of strengthening the securities market infrastructure and bringing about improvement in the secondary market trading, liquidity and turnover in Government securities as also for encouraging voluntary holding amongst a wider investor base. The primary dealer system has been in operation in India for the last eight years (Box IX.1).

9.21 There were 18 primary dealers (PDs) in operation in India at the end of March 2004 (Table 9.2). Bidding commitments in Treasury Bill auctions for all PDs taken together were fixed at 121.8 per cent of the issue amount indicated to be raised in 2003-04. Total bids received at Rs. 99,279 crore amounted to 157.78 per cent of the total Treasury Bill issues of Rs. 62,921 crore. For dated securities auctions, the bidding commitments for all PDs taken together were originally fixed at Rs.1,31,000 crore. Subsequently, the bidding commitments were reduced to Rs. 98,200 crore due to the reduction in the market borrowing programme of the Government. Actual bids tendered by PDs at Rs.1,10,953 crore were 110.95 per cent of the amounts notified. The success ratio was 66.6 per cent for Treasury Bills and 45.1 per cent for dated securities in 2003-04 as against 62.6 per cent and 45.3 per cent, respectively, in the previous year. PDs offered Rs.1,00,000 crore for underwriting primary issues during the year, out of which bids for Rs.49,150 crore were accepted by the Reserve Bank. The share of total primary purchases by the PDs was higher in 2003-04 at 67 per cent (for Treasury Bills) as against 65 per cent during 2002-03. For dated securities, PDs' share was lower at 50.1 per cent as against 63.0 per cent in 2002-03, reflecting a more aggressive interest in the primary market by other investors. The share of turnover of PDs in outright market for Government securities has declined in recent years, reflecting increased participation by banks. The total bidding commitment (for auctions other than those under the MSS) for the year 2004-05 for dated securities for all PDs has been fixed at Rs. 1,20,300 crore (96.5 per cent of the borrowing programme), while the same for Treasury Bills amounted to 122.6 per cent of the issue amount to be raised. The liquidity support limit under the Standing Liquidity Facilities to all PDs was fixed at Rs. 3,000 crore, *i.e.*, at a lower level than for 2003-04.

Box IX.1
Primary Dealer System - A Cross-country Experience

Primary dealers are financial intermediaries that agree to perform specific obligations or functions in the market for Government securities in exchange for specific privileges. The objectives of the PD system are to ensure that the Government's financing needs and its obligations are met at the lowest possible cost consistent with a prudent degree of rollover risk. The obligations of PDs include (i) participating in the primary market in a substantial and consistent manner; (ii) serving as a market maker in the secondary market by providing two-way quotes; and (iii) providing market related information to the public debt manager.

The system of PD was first established in the US in 1960. In India, it was introduced in 1996. Some advanced countries such as Australia, Germany and New Zealand have not yet established the PD system. According to the IMF's cross country survey in 2003, important prerequisites for establishing a PD system include (i) a debt issuance strategy which provides a medium term horizon of the investment; (ii) interest rate liberalisation in the Government securities market to ensure efficient price discovery; (iii) an adequate number of end investors; (iv) a diversified maturity spectrum in Government securities; (v) policy impetus for developing the secondary market for the Government securities without direct intervention; and (vi) a competitive market environment (Table).

The IMF survey also brings out the crucial role played by the supporting market segments (such as inter-bank and local capital markets) and the infrastructure (such as book-entry system, D*v*P and bidding technology). This supporting system is, however, still under-developed in many countries. With electronic trading of securities and auctions, which effectively expand investor base, the role of PDs in developed economies is losing importance. PDs, however, continue to play a critical role where the fiscal deficits and financing needs of the Government are large.

In India, the PD system has contributed to the development of a deep and vibrant market for the Government securities. Several issues such as granting the PDs limited exclusivity in the Treasury Bills auctions and permitting them to invest in overseas sovereign bonds and setting of joint ventures (JVs)/wholly owned subsidiaries (WOSs) abroad to enable them to diversify their balance sheets are under examination.

Reference

1. Armone, M. and G. R. Iden (2003), "Primary Dealers in Government Securities: Policy Issues and Selected Countries' Experience", *IMF Working Paper No. 45.*

Table : Features of PD System in Various Countries

Country	Starting Date	No. of PDs	Open Market Operations	Availability of Liquidity of Stock Facilities with the Central Bank	Debt/GDP ratio (Per cent)	Periodicity of Review
1	2	3	4	5	6	7
Argentina	1996	12	Yes		30	Annually
Brazil	1974	22	Yes		40	Semi-annually
Canada	1998	12	Yes	Yes	70	Bi-annually
France	1987	18			30	Every 2 years
Hungary	1996	13			70	Semi-annually
India	1996	17	Yes	Yes	50	Annually
Italy	1994	16			120	Every 2 years
Korea	1997	26			10	Annually
Mexico	2000	5		Yes	20	Semi-annually
Singapore	1987	11	Yes	Yes	90	Semi-annually
Thailand	2000	9	Yes		60	Annually
UK	1986	17			40	Semi-annually
US	1960	25	Yes	Yes	50	Semi-annually

Source: Armone and Iden (2003).

9.22 The Reserve Bank issued operational guidelines to PDs to undertake portfolio management service (PMS) for entities other than those regulated by the Reserve Bank subject to (a) prior approval of the Reserve Bank, (b) receipt of certificate of registration from the SEBI and (c) compliance with the operational guidelines issued by the Reserve Bank. PDs were allowed to deal in IRFs on notional bonds and Treasury Bills both for hedging and for holding trading positions. The prudential guidelines

Table 9.2: Select Indicators of Primary Dealers

(Rs. crore)

Item	March 2004	March 2003	March 2002	March 2001
1	2	3	4	5
Number of PDs	18	18	18	15
Total capital (NOF)	5,972 @	5,055	4,371	3,184
Total assets	18,360 @	17,378	15,305	14,772
of which: Government securities (G-Secs)	16,108 @	14,573	12,217	10,401
G-Secs as percentage of total assets	88 @	84	80	70
PD system turnover (outright)	8,10,250	7,32,143	6,52,127	3,16,915
Market turnover (outright)	32,30,790	27,55,482	24,23,933	11,44,291
PD turnover as percentage of outright market turnover	25.1	26.7	26.9	27.7
Liquidity Support Limits	4,500	4,500	6,000	6,000
Normal #		3,000	4,000	
Backstop #		1,500	2,000	
CRAR (per cent)	41.6	29.7	38.4	40.9

NOF : Net Owned Fund.
@ : Unaudited.
# : Normal and backstop facilities, which were introduced on May 5, 2001, were combined effective March 29, 2004.
Note : Turnover data pertain to the financial year.

on investments by PDs in non-Government securities in both primary and secondary segments were also prescribed in March 2004. Investments in unrated non-Government securities were prohibited, while investment in unlisted non-Government securities was allowed up to 10 per cent of their total non-Government securities portfolio. Prudential guidelines on dividend payout were issued in June 2004. The dividend payout ratio was linked to CRAR and a ceiling on individual payout ratio was fixed.

9.23 The periodical supervisory returns being submitted by PDs were rationalised and simplified. A new quarterly return (PDR-IV) on certain balance sheet and profit and loss (P&L) indicators was introduced from the quarter ended March 31, 2004. Revised 'capital adequacy standards and risk management guidelines' for PDs were issued in January 2004. In terms of the guidelines, the minimum holding period for Value at Risk (VaR) was reduced from 30 days to 15 days. This is expected to reduce capital charge for market risk and enable PDs to hold higher portfolios. The reporting of capital adequacy was standardised. Some off-balance sheet items (such as underwriting commitments), which were not included earlier, were reckoned for risk weighted assets. Besides off-site supervision through structured returns, the Reserve Bank also conducts on-site inspection of PDs. During the year, the inspection of 15 PDs was undertaken.

9.24 The CCIL, which offers clearing and settlement facilities for inter-institutional Government securities transactions and inter-bank foreign exchange transactions, has been recognised as a Systemically Important Payment System (SIPS). The CCIL's turnover in the Government securities segment increased by 63.0 per cent to Rs. 25,18,323 crore in 2003-04. The caps placed by the Reserve Bank on call money borrowings by banks and PDs, the increased activity in the repo market segment and the general upswing in the securities market boosted the CCIL's turnover.

FOREIGN EXCHANGE MARKET

9.25 A number of measures were undertaken during the year to deepen the foreign exchange market and impart flexibility to market participants. The focus was on providing an enabling environment for all entities to engage in foreign exchange transactions. A host of new measures were introduced to further deepen the foreign exchange market (Box IX.2). Liberalisation of foreign exchange transactions was extended to residents, non-residents and corporates. The thrust of liberalisation was on greater transparency, data monitoring and information dissemination and a regulatory shift from micro management of foreign exchange transactions to macro management of foreign exchange flows. Reflecting this, the Exchange Control Department (ECD) of the Reserve Bank was renamed as the Foreign Exchange Department (FED) effective January 31, 2004. Simultaneously, procedural formalities are being minimised to avoid paper work and to reduce compliance burden, while ensuring that Know-Your-Customer (KYC) guidelines are in place.

Box IX.2

Initiatives for Developing the Foreign Exchange Market in 2003-04

Forward Contracts - Residents

- Residents were allowed to book forward contracts and participate in hedging instruments for managing risk in the foreign exchange market. Authorised Dealers (ADs) were allowed to offer foreign currency-rupee options on a back-to-back basis or run an option book as per specified terms and conditions.
- Residents were permitted to book forward contracts for hedging transactions denominated in foreign currency but settled in rupees.
- Resident entities were also allowed to hedge their overseas direct investment exposure against exchange risk.
- The eligible limit for booking of forward contracts by exporters/importers was increased to 50 per cent (from 25 per cent earlier) of the average of the previous three financial years' actual import/export turnover or the previous year's turnover, whichever is higher, (from only average of past three years' turnover earlier) without any limit (US $ 100 million, earlier). Importers/exporters desirous of availing limits higher than the overall ceiling of 50 per cent were allowed to approach the Reserve Bank for permission.
- ADs were permitted to enter into forward/option contracts with residents who wish to hedge their overseas direct investment in equity and debt. These contracts could be completed by delivery or rollover up to the extent of market value on the due date.

Forward Contracts -Non-residents

- Non-residents were permitted to enter into forward sale contracts with ADs in India to hedge the currency risk arising out of their proposed FDI in India.
- Holders of FCNR(B) accounts were permitted to book cross-currency forward contracts to convert the balances in one currency into another currency in which FCNR(B) deposits are permitted.
- FIIs were permitted to trade in exchange traded derivative contracts approved by the SEBI subject to the limits prescribed by it.
- NRIs were allowed to invest in exchange traded derivative contracts approved by the SEBI out of rupee funds held in India on a non-repatriable basis.

9.26 A significant policy change in 2003-04 was derecognition of the overseas corporate bodies (OCBs) in India as an eligible class of investor under various routes/schemes available under the Foreign Exchange Management Act (FEMA). OCBs were not allowed to undertake (i) fresh investments under FDI schemes; (ii) purchase of shares/convertible debentures; (iii) purchase of Government dated securities or Treasury Bills or units of domestic mutual funds; (iv) lending in foreign currency to residents; and (v) to open and maintain non-resident deposit accounts.

Capital Account Liberalisation

9.27 Capital account transactions were further liberalised during 2003-04. Relaxations were allowed for overseas investments and remittances abroad by banks, corporates, resident and non-resident individuals. Policy initiatives to improve the inflows of foreign direct investment, foreign portfolio investment and external commercial borrowings were also carried forward during the year.

Facilities for Resident Individuals

9.28 Resident individuals were allowed to remit up to US $ 25,000 freely per calendar year for any permitted purposes under the current and the capital account. Under this scheme, resident individuals were permitted to acquire and hold immovable property or shares/portfolio investment or any other asset outside India without prior approval of the Reserve Bank. They were also allowed to open, maintain and hold foreign currency accounts with a bank outside India for making remittances without prior approval of the Reserve Bank. Resident beneficiaries were permitted to open and credit the proceeds of insurance claims/ maturity/surrender value settled in foreign currency to their resident foreign currency (RFC) domestic accounts.

9.29 Indian students studying abroad were made eligible for all facilities available to non-resident Indians (NRIs) under the Foreign Exchange Management Act (FEMA). They would, however, continue to avail of educational and other loans as residents in India. The limit for foreign exchange remittance by resident individuals for current account purposes other than import without documentation formalities was raised to US $ 5,000 from US $ 500.

9.30 ADs were permitted to allow remittances for (i) securing insurance for personal health from a company abroad; (ii) covering expenses by artists while touring abroad; (iii) commission to agents abroad towards sale of residential flats/commercial plots in India up to US $ 25,000 or five per cent of the inward remittance per transaction, whichever is higher; (iv) short term credit to overseas offices of the Indian companies; (v) advertisements on foreign television channels; (vi) royalty up to five per cent of local sale and eight per cent of exports and lump sum payment not exceeding US $ 2 million; and (vii) use and/or purchase of trademark/franchise in India.

9.31 The limit for release of foreign exchange for employment abroad, emigration, maintenance of close relatives abroad and education abroad was increased to US $ 1,00,000 on the basis of self declaration. The limit for release of foreign exchange for medical treatment abroad without estimate from a hospital/doctor was increased to US $ 1,00,000 from US $ 50,000. The limit for remittance towards consultancy services from outside India was raised to US $ one million per project from US $ 1,00,000. Resident individuals were permitted to take interest free loans from close relatives residing outside India up to US $ 250,000 with a minimum maturity period of one year.

9.32 Resident individuals maintaining foreign currency accounts with ADs in India or banks abroad were allowed to obtain International Credit Cards (ICCs) issued by overseas banks and other reputed agencies. While no monetary ceiling was fixed by the Reserve Bank for remittance under ICCs, the applicable limit is the credit limit fixed by the card issuing banks. Diplomatic missions, diplomatic personnel and non-diplomatic staff of foreign embassies were allowed to maintain foreign currency deposit accounts in India.

9.33 Remittance of the net salary of a citizen of India on deputation to the office or branch of an overseas company in India was allowed for the maintenance of close relatives residing abroad.

9.34 Balances in the exchange earners' foreign currency (EEFC) and resident foreign currency (domestic) [RFC(D)] accounts were allowed to be credited to non-resident (external) (NRE) rupee/ foreign currency non-resident (banks) [FCNR(B)] accounts at the option of the account holders consequent upon change of residential status (to non-resident).

Facilities for Corporates

9.35 Steps were taken to encourage outflows that would enhance the strategic presence of Indian corporates overseas. They were allowed to invest in overseas joint ventures (JVs)/wholly owned subsidiaries (WOSs) up to 100 per cent of their net worth. This facility was also extended to partnership firms. Resident corporates and registered partnership firms were allowed to undertake agricultural activities overseas, including purchase of land incidental to this activity, either directly or through their overseas offices, *i.e.*, other than through JVs/ WOSs, within the overall limit available for investment overseas under the automatic route. This would enable Indian companies to take advantage of global opportunities and also to acquire technological and other skills for adaptation in India. The automatic route for overseas investment was widened to cover investment overseas through special purpose vehicles (SPVs) and by way of share swaps with requisite approval processes.

9.36 Foreign banks operating in India were permitted to remit net profits/surplus (net of tax) arising out of their Indian operations to their head offices on a quarterly basis without prior approval of the Reserve Bank. Corporates were permitted to issue equity shares against lump sum fees, royalty and outstanding external commercial borrowings (ECBs) in convertible foreign currency. General permission was granted to foreign entities for setting up project offices in India. These project offices were permitted to open foreign currency accounts with the Reserve Bank's approval. Permission was also granted to foreign companies to establish branch offices/units in special economic zones (SEZs) to undertake manufacturing and service activities subject to certain conditions.

9.37 Keeping in view the comfortable foreign exchange reserves and the prevailing strength of India's external sector, a comprehensive review of the guidelines for ECBs led to significant liberalisation. The revised ECB guidelines allowed (i) corporates to access ECBs for undertaking investment activity in India and for overseas direct investment in JVs/WOSs, and (ii) borrowings under the approval route by financial institutions dealing exclusively with infrastructure or export finance and also by banks and financial institutions which had participated in the textile or steel sector restructuring package. The maximum amount of ECB that can be raised by Indian corporates under the automatic route was enhanced to US $ 500 million in a financial year with minimum average maturity of three years for loans up to US $ 20 million and minimum average maturity of five years for loans above US $ 20 million. Initiatives were taken for bringing about transparency in policy implementation and data dissemination with respect to ECBs.

9.38 Indian companies were permitted to grant rupee loans to their employees who are NRIs or persons of Indian origin (PIO) for personal purposes, including purchase of housing property in India.

Facilities for Exporters and Importers

9.39 The remittance of premium made by exporters for overseas insurance of exports of sea-food and other perishable food/food products against rejection by importers was permitted. ADs were allowed to grant permission to exporters for opening/hiring of warehouses abroad initially for one year and renewal thereof. Units in domestic tariff areas (DTAs) were allowed to make payment in foreign currency towards goods supplied to them by units in SEZs. Project/ service exporters were allowed to pay their Indian suppliers/ service providers in foreign currency from their foreign currency accounts maintained in India for execution of such projects. Realisation of export proceeds up to 360 days from the date of shipment was allowed for export of books on a consignment basis.

9.40 The limit on export of goods by way of gifts was increased from Rs. 1 lakh to Rs. 5 lakh per annum. With effect from April 1, 2004 submission of declaration in form GR/SDF/ PP/SOFTEX in respect of export of goods and software of value not exceeding US $ 25,000 or its equivalent was waived.

9.41 The limit for submission of documentary evidence of all imports made into India was enhanced from US $ 25,000 to US $ 1,00,000. For select importers, the limit for accepting exchange control (EC) copy of bill of entry for import remittances was enhanced from US $ 1,00,000 to US $ one million, subject to certain conditions.

9.42 Credits for imports up to US $ 20 million per transaction with a maturity period beyond one year and up to three years were permitted only for import of capital goods. Limits for direct receipt of import bills/documents by non-corporate importers were raised to US $ 100,000 or its equivalent.

9.43 Exporters with good track record, including those in small and medium sectors, have been made eligible for issue of Gold Card to ensure easy availability of export credit. The salient features of the Gold Card scheme include better terms of credit than those extended to other exporters by banks, faster and simpler processing of applications for credit, sanction of 'in principle' limits for a period of three years with the provision of timely renewal and preference for grant of packing credit in foreign currency. The Gold Card holders will also be considered for issuance of foreign currency credit cards for meeting urgent payment obligations on the basis of their track record of timely realisation of export bills.

Facilities for Overseas Investments

9.44 Listed Indian companies were permitted to disinvest their investment in JVs/WOSs abroad even in cases where such disinvestment may result in a write-off of the capital invested to the extent of 10 per cent of the previous year's export realisation. Firms in India registered under the Indian Partnership Act, 1932 and with a good track record were permitted to make direct investments outside India in an entity engaged in any *bona fide business* activity under the automatic route up to 100 per cent of their net worth.

9.45 Multilateral institutions such as International Finance Corporation (IFC) and Asian Development Bank (ADB), which can float rupee bonds in India, were permitted to purchase Government dated securities.

Facilities for Non-resident Indians (NRIs) and Persons of Indian Origin (PIO)

9.46 Non-resident shareholders were allowed to apply for issue of additional equity shares or preference shares or convertible debentures over and above their rights entitlements. Allotment is subject to the condition that the overall issue of shares to non-residents in the total paid-up capital of the company does not exceed the sectoral cap.

9.47 NRIs were permitted to invest in exchange traded derivative contracts approved by the SEBI out of rupee funds held in India on a non-repatriable basis, subject to the limits prescribed by the SEBI. Foreign Embassies /Diplomats/Consulate Generals were allowed to purchase/sell immovable property in India other than agriculture land/plantation property/farm houses.

9.48 ADs were permitted to grant rupee loans to NRIs. Earlier, housing loans availed by NRIs/PIO could be repaid by borrowers either by way of inward remittances through normal banking channels or by debit to NRE/FCNR(B)/NRO/NRNR/ NRSR accounts or out of rental incomes derived from the property. In May 2004, borrowers' close relatives in India were allowed to repay the instalment of such loans, interest and other charges directly to the concerned ADs/ housing finance institutions through their bank accounts.

Foreign Exchange Clearing

9.49 An important element in the infrastructure for the efficient functioning of the foreign exchange market has been the clearing and settlement of inter-bank US dollar-rupee transactions. The CCIL offers a multilateral netting mechanism through a process of novation for inter-bank spot and forward US dollar-rupee transactions. The live operations of foreign exchange clearing, which commenced from November 12, 2002 have been satisfactory. Effective February 2004, the CCIL began to settle cash and T+1 settlement trades in addition to spot and forward trades. The CCIL also launched its foreign exchange trading platform, *i.e.,* FX-CLEAR on August 7, 2003. During the period between April 2003 and June 2004, 8,97,352 trades amounting to over US $ 727 billion were settled by the CCIL.

Outlook

9.50 The Reserve Bank would continue to calibrate the process of building various segments of the financial market with overall macroeconomic developments with a view to improving allocative efficiency and ensuring financial stability. In the near term, the reintroduction of Capital Indexed Bonds (CIBs) with modified features would improve the width of the Government securities market. Harmonisation of the regulatory prescriptions for OTC and exchange traded interest rate derivatives with clearing arrangements through the CCIL is under consideration. Enhancements in hardware and software systems and functionalities including introduction of anonymous, screen-based and order matching in the NDS are also underway. The operationalisation of the RTGS would bring speed and efficiency to financial transactions. The ongoing upgradation of the CCIL-NDS and the other elements of technological infrastructure, introduction of new instruments, the sequenced process of developing the call/notice money market into a pure inter-bank market, the concurrent development of other market segments and the gathering pace of exchange and payments liberalisation are all expected to deepen financial markets and ensure stability and vibrancy.