N S P...

REGULATION OF THE INDIAN STOCK MARKETS;

A PRELIMINARY SURVEY

By: Norman S. Poser and David Silver

January 1965

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

OFFICE OF
THE COMMISSIONER

FEB 9 1965

Honorable David E. Bell, Administrator
Agency for International Development
Department of State
Washington, D. C.

Attention: C. Herbert Rees, Director
Office of South Asian Affairs

Dear Mr. Bell:

I am transmitting herewith a report prepared by two Commission staff members, Norman S. Poser and David Silver, on the Indian securities markets. The report is based on a visit which they recently made to India at the request of the Government of India and under the auspices of the Agency for International Development.

I should state that, as the report points out, the views expressed are those of these staff members and of course under the circumstances cannot represent the opinions of the Commission.

Sincerely yours,

Byron D. Woodside
Commissioner

Enclosure

TABLE OF CONTENTS

I. INTRODUCTION

A. Background of the survey

This report was written as the result of a two-week visit to India in November 1964 by two staff members of the United States Securities and Exchange Commission, Norman S. Poser, Assistant Director, and David Silver, Special Counsel to the Director, both of the Division of Trading and Markets. The trip was made pursuant to a request to the Commission by the Agency for International Development mission in New Delhi that a team be sent to India in order to determine whether the Commission, or the American stock exchanges, might be of assistance to the Government of India in improving the operation and regulation of the Indian stock exchanges. The recommendations contained in this report are therefore not for any affirmative action by the Government of India or the Indian exchanges but rather they relate to the question of what further assistance can be given.

Two important points should be made: First, it should be emphasized that the views expressed in this report are those of the authors only, and are not necessarily the views of the Commission. Secondly, the brevity and nature of this survey compelled the authors to rely on what was told to them; they had little or no opportunity to verify the information that they received, and the factual content of this report is offered "on information and belief." Nevertheless, they are convinced that the general conclusions and areas of concern discussed in the report are correct. In this regard it should be mentioned that both of the authors served as staff attorneys on the Special Study of Securities Markets of the Securities and Exchange Commission between 1961 and 1963; they believe that this experience is of value in their present task of pinpointing the problems of a different but not altogether dissimilar system of securities markets. Nevertheless, all of the recommendations must necessarily be viewed as tentative in nature. Some would require further study and are so phrased, others could not be implemented except over a period of time, and all of them must pass the final test of practicality in the context of the Indian markets. There would have to be a period of discussion with the Indian financial community, collection of data, and finally the drafting of new rules and in some cases legislation.

During the two-week survey, the authors visited and observed trading on the Bombay, Calcutta, and Delhi stock exchanges. They also had extended discussions with Governement officials, members of stock exchanges, and officials of banks and other financial institutions. Among the persons interviewed were:

Government: T. T. Krishnamachari, Finance Minister; R. C. Dutt, Secretary, Department of Company Law and Insurance; V. D. Sonde, Director, Stock Exchange Division; and N. C. Maitra, Deputy Director, Stock Exchange Division.

Financial institutions: A. Baksi, Chairman, Industrial Finance Corporation; C. H. Bhabha, Vice-Chairman, Central Bank of India; R. S. Bhatt, Chairman, Unit Trust of India; Tulsidas Kilachand, Chairman, Bank of Baroda; G. L. Mehta, Chairman, The Industrial Credit and Investment Corporation of India (ICICI); S. K. Pandya, Deputy General Manager, United Commercial Bank; and H. T. Parekh, General Manager, ICICI.

Stock exchange administration: K.R.P. Shroff, President, Bombay Stock Exchange; C. L. Jhunjhunwala, President, Calcutta Stock Exchange; B. J. Jeejeebhoy, Secretary, Bombay Stock Exchange; and members of the Governing Boards of the Bombay, Calcutta, and Delhi stock exchanges.

Broker-dealers: S. B. Bilimoria, Bathivala and Karani; V. B. Desai and K. Kreshvala, Lewis & Jones; R. G. Edwards, Place, Siddons & Gough; Kantilal Ishwerlal; B. C. Roy, N. L. Roy & Co.; N. N. Saher, Merwanjee Bomanjee.

Also: N. A. Palkhivala, Bombay attorney and co-author of _The Law and Practice of [Indian] Income Tax_, 2 vol., 1963.

The authors wish to express their thanks and appreciation to each of these people, who treated them with uniform kindness and were willing to discuss questions of great complexity in a frank and comprehensive manner. The authors especially wish to thank Messrs. Sonde and Maitra, who patiently guided them throughout the survey.

B. The Underlying Problem.

The underlying problem of the Indian securities markets is lack of investor interest. Although the general state of business in the country appears to be good and profits and dividends have generally been high, the securities markets have been in the doldrums since 1962. From 1959 to 1962 the Indian markets, like those of the United States, enjoyed a boom both in the new issue and the trading markets. The decline of prices in the United States culminating in the May 1962 market break was paralleled by a similar decline in India. In October 1962, the invasion of India's borders by communist China placed the country in a state of emergency and, as we understand it, created something resembling a panic among investors in Indian securities. Whereas the new issue market in the United States has not fully recovered from the 1962 market break, the exchange markets, as reflected by the New York Stock Exchange, have generally recovered both in terms of activity and price level. In India, by contrast, both the new issue and the trading markets have remained inactive since 1962 and prices have generally continued to decline. One observer has described the situation by saying, "underwriters are undertakers, and brokers are broke." The Indian Government has become increasingly concerned with the problem because private investment is regarded as having a significant role in the growth of the Indian economy.

The explanations given for the continued pallor of the Indian markets vary greatly. Members of the securities industry (as well as others) lay the blame on the Government's fiscal policies, which they characterize as confiscatory and too changeable. In arguing that potential investors, principally the salaried urban classes, have no savings to invest, they point to the rising cost of living, to high rates of taxation, and to the existence of various taxes affecting stockholders, including a tax on receipt of bonus shares (stock dividends). They state further that frequent changes in Government fiscal policy and general uncertainty over the future have created a "crisis of confidence" for investors.

Government representatives agree that confidence is lacking, but they attribute this to suspicion by the public of the exchanges, which they regard as "closed clubs." They take the position that the lack of buying interest in securities is a direct result of insider dealing and other abuses by corporate management and broker-dealers during the 1959-62 boom. They also stress the lack of requirements for corporate disclosure comparable to those in the United States and the lack of adequate qualifications standards for broker-dealers. They argue that it is futile to expect any large segment of the public to invest in a market which is largely unregulated and about which they have little or no opportunity to obtain adequate information upon which to base investment decisions.

It may be noted that this divergence of views did not entirely represent a split along government-industry lines. For example, certain important brokers felt that selling excesses during the new issue boom were in part responsible for the current lack of public confidence, and some persons with government connections were critical of aspects of the Government's fiscal policy.

We are not in a position to evaluate these competing but not necessarily conflicting considerations, and of course we cannot comment on the views expressed concerning India's fiscal policies. We note, however, that the very existence of these views may have an adverse effect on the market. On the other hand, there is evidence that the Indian public has retained savings after taxation, which it does not choose to invest directly in the stock market. The success of the Government's unit trust, discussed below, and the recent practice of investing money in companies' non-negotiable deposit receipts are among the factors that tend to indicate that the public has savings which it is willing to invest so long as it does not have to submit them directly to the vagaries of the market place.

We conducted our survey on the premise that improvement in the operation and regulation of the stock exchanges can increase the confidence of investors and stimulate interest in purchasing securities that are traded on the Indian exchanges. In general, all of the tentative recommendations made in this report are based on this premise. The thrust of the recommendations is to assure a fair and open market place, responsive to the needs of a potentially broad investing public, and to make certain that investors have the maximum amount of honest information about the securities traded in the markets. Our task as we saw it was to ascertain what assistance the Securities and Exchange Commission or the American exchanges can render for this purpose.

C. The Indian Stock Markets

Before attempting a discussion of the problems besetting the Indian stock markets, it seems desirable to describe briefly these markets and a few of the more important factors affecting them.

The Securities Contracts (Regulation) Act of 1956 provides the general legal framework for the stock markets.*/ The Act provides that no stock exchange may operate unless recognized by the Government. In areas where a recognized exchange is located, all securities transactions except those executed between or through members of such exchanges are prohibited. The Government also has power to make or amend the rules and bylaws of an exchange, to nominate up to three members of its governing body, to require an exchange to take action against members violating the statutes or the rules of an exchange, to make inquiry into the affairs of the governing body and members of an exchange, to require the maintenance of books and records and the filing of reports by an exchange, to prescribe minimum qualifications for membership, to suspend the business of an exchange or withdraw its recognition, and to compel public companies to list their securities on an exchange.

At the present time there are eight recognized exchanges: Bombay, Calcutta, Madras, Ahmedabad, Hyderabad, Delhi, Indore, and Bangalore. The Government's recognition of the Bombay Stock Exchange is permanent, while

---

*/ It should be noted that the provisions of the Act are applicable only to transactions other than spot delivery contracts, i.e. contracts for immediate delivery. The other methods of clearing, settlement and delivery are described in a later section of this report.

that of the others is on a five-year basis, which has been renewed from time to time. Bombay is the oldest and the most important exchange. Its position of leadership is attested by the fact that upon enactment of the Securities Contracts Act the other recognized exchanges adopted rules identical to those of the Bombay. As of a recent date, the Bombay Stock Exchange has about 500 members and about 600 listed securities.

The Calcutta Stock Exchange, while less important in terms of prestige and value of listed securities, nevertheless has more members (about 650) and listed stocks (about 900) than Bombay. It provides a market principally for shares of local industrial companies. The Madras Stock Exchange (which we did not visit) has the reputation of being the most conservative and least speculative-minded of all Indian exchanges. The other five exchanges are of considerably less importance, with the possible exception ofthe Ahmedabad Stock Exchange, which is the third oldest exchange and which provides a market for shares of local textile mills. The exchanges in Bombay, Calcutta, Ahmedabad, and Delhi have auction markets; while those in Madras, Hyderabad, Indore, and Bangalore have call markets.

Some recognition of the role of institutional investors is essential for an understanding of the Indian stock markets. One reason that has been given for the decline of the markets in 1962 and their subsequent failure to revive was the lack of institutional investment. It should be noted that there are very few institutional investors in India. A reason for this is that in 1955 the Government nationalized all life insurance companies and the resulting single Government Life Insurance Company (LIC) has become the largest single investor and an important underwriter.

In July 1964 the Government initiated its unit trust, which is in essence a Government-owned mutual fund. The unit trust initially sold its shares to the public in units of 10 rupees and stands ready to redeem them at current asset value. As of November 1964 the Government had not officially disclosed the amount of money raised by the unit trust or identified the securities in which the unit trust had invested, but we understand that it had by that time sold unit trust shares valued at a total of approximately 18 crores of rupees ($36,000,000), and that its portfolio was diversified and included a substantial amount of common stock.

The unit trust offers attractive inducements to the public. Besides the fact of Government sponsorship, which is of no small importance in view of the general lack of confidence in the markets and the securities industry, there are also solid tax advantages in a unit trust investment. The unit trust is exempt from all taxation, and the first 1,000 rupees of dividends and 5,000 rupees of capital gains received by a holder of unit trust shares are tax exempt.

The LIC and the unit trust, because of their growing assets, seldom sell shares. In fact, they are said to provide the sole significant buying interest in the stock market today. Even recognizing this, there are certain disadvantages to the market in the concentration of substantially all institutional investment in two units. For example, if the unit trust desires to purchase stock of a company it may be difficult to find sufficient sellers to insure continuity in the market, whereas if there were a large number of institutional investors presumably some would be selling while others are buying.

It should also be noted in passing that certain other institutions play a major role in the underwriting of Indian securities. These include the Industrial Credit and Investment Corporation of India (ICICI) and the Industrial Finance Corporation (IFC), which are Government-sponsored financial institutions established for the principal purpose of aiding in the economic development of the country. Owing to the lack of buying interest in the stock market, these institutions have in recent years been obliged to take up a large percentage of new issues.

Banks are another important factor in the Indian stock markets. They not only act as underwriters but also provide credit for securities transactions. We understand that the Reserve Bank of India has "recommended" to the banks that they do not advance money for the purpose of speculation in the market.*/ This policy apparently stems from the understandable desire of the Government to channel credit resources into productive uses. It nevertheless should be recognized that the policy further inhibits an already inactive and depressed market. The Government's role in restricting credit should not however be overstated; the banks themselves may be reluctant to extend credit to the stock market because of lack of marketability of shares under present conditions, the possibilities of fraud, and the difficulties of foreclosing on hypothecated securities under applicable Indian law.

---

*/ As noted in Section III, this policy seems to represent an attempt to discourage certain speculative excesses connected with forward trading in securities.

II. THE BROKER-DEALER COMMUNITY

As stated above, the Securities Contracts (Regulation) Act of 1956 prohibits trading in securities in the area of any recognized exchange except by members of that exchange. The Act further provides for the licensing of broker-dealers in other areas of the country, but these provisions have not thus far been implemented. The broker-dealer community is thus officially limited to the members of the various recognized exchanges.

The membership of the major exchanges is sharply (but unofficially) divided into two segments. On the one hand there are a limited number of so-called "investment brokers," perhaps not more than 20 or 25 in India, who account for approximately 10 percent of trading in securities. The other 90 percent is done by members who seem principally to engage in speculative trading for their own account and to a limited extent for the account of customers. In addition, there are an unknown number of non-members of any exchange who engage in curb (or street) trading in violation of law. The differences in policies and practices between investment brokers and speculative dealers appear to be very wide.

The few investment broker firms that we interviewed would not compare unfavorably in competence and ethics with the average New York Stock Exchange member firm. Place, Siddons & Gough, the largest securities firm in Calcutta, pursues conservative policies, does not trade for firm or partners' account, does not accept customers who wish to speculate or engage in forward trading, and requires a bank reference or substantial margin deposit from its customers. Other investment brokers, such as

Lewis & Jones in Bombay, follow similar policies. These firms are small by American standards, usually having 2 or 3 partners and in no case more than 5 or 6. They generally employ from 25 to 100 people, divided among assistants (who make recommendations and handle orders for customers) bookkeepers, and statistical and clerical personnel. These firms apparently maintain adequate books and records and correspond generally to the responsible firms in the United States that do a public business.

Speculative traders, who comprise the great majority of the membership of the stock exchange, trade largely for their own account, maintain no office or at the most a desk in one of the buildings adjoining the stock exchange, and apparently keep only the sketchiest of books and records.*/ We were informed that many of these members participate in the illegal curb market but run these trades through their accounts as exchange transactions. Furthermore, they allow their books to be used by nonmembers who engage in forward trading on the curb market, in order to make use of the exchange's clearing facilities and to disguise the fact that these activities are in violation of law and exchange rules.

A frequent criticism made of the broker-dealer community is that many members have close ties with listed companies, and that they engage in

---

*/ Owing to various difficulties, we did not have an opportunity to interview any speculative traders and our knowledge of their methods of doing business is based entirely on second-hand information.

manipulations of their stocks or employ inside information in their own transactions. The nature and brevity of our survey did not permit any inquiry into these allegations, but there can be no doubt that close contacts between broker-dealers and listed companies exist.

A number of broker-dealers, both investment brokers and speculative traders, sit as directors on the boards of listed companies. For example, each of the four partners of Place, Siddons & Gough is a member of the boards of from 15 to 20 companies. This practice is related to the fact that such firms act as underwriters or brokers in the offering of new issues of these companies, and wish to retain a continuing relationship with them. In the case of investment brokers that do not engage in trading for their own account, any conflicts of interest arising from the relationship are minimized.*/

In the case of speculative traders and taravaniwallas (jobbers), problems arising from contact between brokers and listed companies are potentially much more serious. First, since these broker-dealers do trade for their own account on the floor of the exchange, they are able to take advantage of inside information for their own benefit. Secondly, some of them may actually control listed companies or may be actively engaged in the management of these companies. For example, the business card of one

---

*/ It should be pointed out that it is quite common for American broker-dealers to sit on the boards of directors of publicly-held companies, and that the need for this practice may be even greater in India than in the United States, since it may be more difficult in India for a company to obtain an experienced financial adviser.

member of the governing board of the Bombay Stock Exchange indicated that he was an officer of a company that manufactured nuts and bolts. The rules of the Bombay Stock Exchange prohibit members from engaging in business other than the securities business except, it may be noted, with permission of the governing board.

The use of inside information in securities transactions to the detriment of the investing public, as much as any other single abuse, is destructive of public confidence in the integrity of the market. Under the securities laws of the United States, such practices are controlled not only by general rules prohibiting fraudulent practices in connection with the purchase or sale of a security and governing the conduct of broker-dealers, but also by specific provisions which require the disclosure of such trading and prohibit short selling by corporate insiders, and which make their short-swing profits recoverable by the company.

While insider abuses probably are prohibited by the general rules of the Indian stock exchanges governing the business conduct of their members, the Government lacks direct powers to control such practices. It is recommended that any revision of the pattern of Indian securities regulation include the development of protections for investors against insider trading abuses. We understand that a statute requiring the disclosure of transactions by major stockholders of publicly held companies has been introduced into the Indian parliament. It does not appear, however, that this proposal standing alone is adequate to control many insider trading abuses, and we would recommend that these provisions be reviewed after further study and investigation of the practices involved have been made.

The qualification of broker-dealers and their employees as to character, competence, and financial responsibility appears to be a major problem of the Indian securities industry. The rules adopted by the Government under the Securities Contracts Act and the rules of the stock exchanges prescribe certain qualifications for membership in a recognized stock exchange. Minors, non-citizens, bankrupts, and persons who have been convicted of an offense involving fraud or dishonesty are excluded from membership. The Bombay Stock Exchange reviews the qualifications of applicants for membership, but it appears that it seldom exercises its discretion to exclude persons from membership for reasons of character.*/ We know of only one otherwise qualified person who was turned down by the Bombay Stock Exchange in recent years; he was discovered to be the nominee of his uncle, a notorious speculator. Unlike American exchanges, the Indian exchanges require that all partners of members (except for close relatives) themselves purchase a seat on the exchange.

---

*/ One reason for this may be that the Bombay Stock Exchange was persuaded to accept a number of members from another exchange in Bombay when it was "recognized" in 1956. According to an Exchange official membership standards were lowered at that time.

The Bombay Stock Exchange also reviews the applications of "remisiers" (salesmen) and authorized assistants, who are employees of members and have the right to transact business on the floor of the Exchange in the name of their employers. The other exchanges do not appear to have any formal procedures for deciding upon applications for membership or for employment.

The rules of the Government and the exchanges also require that an applicant for membership have worked with a member for two years or that he agree to do so for two years, during which time he will not enter into transactions in his own name. These requirements may be waived by the governing body of an exchange if it believes that an applicant is otherwise qualified for membership. We understand that, at least at the Bombay Stock Exchange, many applicants are admitted on the basis of a waiver of the requirements.*/

Our discussions with representatives of several firms which may be characterized as investment brokers and perusal of market literature and other published material of these firms give us no reason to doubt their qualifications to advise and transact business for the public. This does not appear to be true, however, of many speculative traders.

---

*/ Some of these persons are probably fully qualified, since they were in the securities business prior to immigrating from Pakistan.

Several persons, including highly placed Government officials, as well as leading members of the financial community, referred to the lack of qualifications among broker-dealers as being one of the most serious problems of the Indian securities markets. As stated above, we did not have an opportunity to interview any traders and, even if we had, it is likely that language difficulties would have prevented us from making any valid assessment of their qualifications to do business. The competence, ethics, and regard for the law in the securities markets of any nation can rise no higher than the quality of the broker-dealers. A study should be made of the qualifications of Indian broker-dealers, with a view to raising the present standards either by the Government or the exchanges and possibly the imposition of an examination requirement for persons wishing to enter the securities business. */

The rules of the Indian exchanges include certain provisions which are intended to insure the financial responsibility of members. Although this does not seem to be a major problem area, it is possible that these requirements are not adequate to insure protection of investors. A member of the Bombay Stock Exchange is required to post a securities

---

*/ It may be noted that the recently completed Special Study of Securities Markets of the Securities and Exchange Commission placed great emphasis on the qualifications of broker-dealers and persons associated with them. The Special Study stated: "If the public is to be protected from the perils of incompetent and irresponsible broker-dealers there should be erected uniform, minimum standards of competence, experience, character, and capital which are applicable to the entire securities industry." (Part 1, page 153).

deposit in the amount of 20,000 rupees. In addition, his seat, currently valued at approximately 29,000 rupees, is considered to be security in case of insolvency. There are no continuing requirements which measure an Indian broker-dealer's financial responsibility against the volume or risks of his business, such as the requirement in the United States that broker-dealers maintain no greater than the 20 to 1 ratio between aggregate indebtedness and net capital.

Furthermore, the books and records of broker-dealers are not as a general rule open to inspection. Both the Government and the exchanges have power to inspect books and records, but these powers are seldom if ever used. Under the Securities Contracts Act the Government may compel the testimony of exchange members and the production of their books and records, but these powers appear to be intended for investigative purposes rather than for routine inspections. The exchanges have similar powers under their rules but in practice the examination of a member firm's books is resorted to only where evidence of wrongdoing has already been alleged. In very serious cases, the Bombay Stock Exchange appoints a committee of inquiry to examine a member's books, but in general the financial condition of exchange members doing business with the public is unknown to anyone but the members themselves. In fact, the general attitude of broker-dealers seems to be that their books and records are privileged and no business of the Government or an exchange; officials of the Bombay Stock Exchange told us, however, that this attitude is changing. It may be that it would be economically and otherwise impractical to establish a system of routine inspections of the books of broker-dealers, such as exists in the United States. Nevertheless, we would recommend review of the adequacy of present record-keeping requirements and the consideration of the institution of spot-check examinations, preferably on a surprise basis, either by Government or exchange auditors.

Building a competent and responsible community of broker-dealers who will serve the interests of the investing public depends not only on ensuring that those who enter the securities industry are qualified; it is also necessary to provide an economic atmosphere in which an efficient broker-dealer can earn a reasonable return on his capital and services without being subjected to undue risks.

At the present time the stock exchanges set maximum commission rates, which average approximately 1.5 percent but there is no minimum commission rate. We understand that many broker-dealers are obliged by competition to reduce their commissions to one-fifth or even one-tenth of the maximum rate, although the well-established investment broker firms generally find it necessary to charge the maximum rate. It is doubtful whether the interests of the public are well served where commissions have to be cut to such an extent that it is difficult for a broker-dealer to provide adequate services to his customers. The Bombay Stock Exchange used to have a minimum commission rate, but there were difficulties of enforcement and it was eventually abandoned.*/ The possibility of reinstituting such a rule, subject to active review by the Government, should be studied.

An area in which action should be considered for the purpose of protecting broker-dealers from undue risks is that of margins. The margin requirements applicable to contracts that are carried forward are discussed in Section III of this report. These margins are required to be furnished only by the broker-dealer, not by his customers. In practice, many broker-dealers are reluctant to require their customers to put up margin, for fear that the customers will take their business elsewhere. Besides allowing increased speculative activity, this system may have the effect of placing the broker-dealer in a precarious position, since he is obliged to provide protection against insolvency or dishonesty of a customer, but does not receive any protection himself. Since the margin requirements are nominal, at least by the standards of the American

---

*/ The Gorwala Committee, which in 1951 rendered a report to the Indian Government on proposed stock exchange regulation, stated:

"There is an unfortunate tendency to continuously reducing scales of brokerage in order to obtain large speculative business. Reasonable scales of brokerage are essential both for enabling efficient service to be given to the public and for the maintenance of proper standards among members of the stock exchange. Reduction by individual members below the minimum to attract business merits the severe displeasure of the governing authorities."

We understand that the minimum rate was abandoned after a court in Bombay held that, where the minimum rate was not charged, the entire contract was invalid.

securities markets, it is unlikely that it would inhibit market activity to any appreciable extent if customers were subjected to the same margin requirements as those applicable to broker-dealers. This too should be an area for further study.

Under the rules of the Indian exchanges members are not permitted to advertise publicly or to solicit persons who are not already their customers. This is in accordance with traditional rules applicable to stockbrokers in England and other countries. It is suggested that this prohibition may be unsuitable for a country such as India, with its great size and population, especially considering the present need to create interest in investment. The ban on advertising has already been ended to a certain extent, since some of the exchanges conduct public relations campaigns that are similar although not as extensive as those of American exchanges. Furthermore, there seems to be a lack of logic in allowing broker-dealers to send out any kind of literature they wish to existing customers, but not permitting any communication at all with prospective customers. We recommend that the subject of advertising and solicitation be reviewed, with attention being paid to the rules and procedures that would have to be adopted by the Government or the exchanges to ensure the accuracy and high quality of any material distributed by broker-dealers.

III. TRADING PRACTICES

A. Trading floor

The two major Indian exchanges, Bombay and Calcutta, like the major American stock exchanges, utilize a continuous system of trading. Although there are no trading posts on the floors of the exchanges each listed security is traded at a particular spot. On the Calcutta Stock Exchange members and authorized non-members who desire to trade in a particular security form themselves into a trading crowd on the floor at the spot where that security is traded. On the Bombay Stock Exchange, members acting as jobbers in particular securities stand on a raised ledge against the walls of the Exchange. Those who desire to deal in the security in which the jobber specializes gather in a trading crowd in front of him.*/

On both exchanges, exchange employees acting as reporters circulate among the various crowds noting transactions. There is no requirement, however, that each transaction be noted by a reporter or that members report every transaction in which they participate. On the Calcutta exchange current transactions are listed in chalk on a large board which can be observed from the floor. The Bombay Stock Exchange has a unique system for the reporting of transactions on a continuous basis. There is an enclosed booth on the floor which contains transmitting equipment. The reporters bring their transaction slips to this booth and an announcer inside reads

---

*/ The Bombay Stock Exchange is currently formulating plans to construct a new modern building, which would have improved floor facilities.

the contents of the slips into a microphone. Receivers are located in the offices of member brokers, many of which are located in the Exchange building. Thus, brokers and their customers can obtain information about current prices, subject to the limitation that not all transactions are reported. There are no other media for the public reporting of transactions either on a current basis or otherwise, except that the daily opening and closing prices are reported in the press and that the two major exchanges publish a daily list which reports a few prices in each security. The other exchanges publish similar lists; some report the closing price only, while others report the opening, high, low and last price.

Daily volume in each security traded on an exchange is not reported. This information is important in apprising investors of liquidity in particular stocks as well as indicating whether a price movement reflects any widespread re-evaluation of the investment merit for the particular security. Absent such information, an investor cannot form such judgments on his own but must wholly rely on the opinions of market professionals.

It should be noted that in India neither the exchanges nor the Government have complete information on exchange volume in the aggregate or in individual securities. Unexplained high volume in a particular stock may be one of the indicia of a market manipulation and is thus a valuable surveillance tool. Furthermore, even aggregate volume information provides some insight into the general trend of the market which is of use to financial institutions and investors.

The major Indian exchanges permit certain non-members to have access to the trading floor, while the major American exchanges restrict access to members. The Indian exchanges permit members to have a specified number of assistants on the floor of the Exchange who may execute orders in the name of their employees. Also, remisiers are permitted on the floor, although they are not allowed to engage in transactions. According to exchange officials, this is to allow them to obtain a "feel" for the market in stocks in which they may be interested. It was also stated that remisiers might bring orders with them to give to members or their assistants for execution. Such orders do not have to be in writing. Under such circumstances there is nothing to prevent a remisier from trading for his own account or for a customer under discretionary authority, on the basis of the trading activity he observes on the floor. Despite the fact that the rules prohibit presence of unauthorized persons on the floor, the authors observed an instance in which unauthorized persons were admitted to the floor of one of the major exchanges under circumstances which made it clear that this was not an isolated case.

Access to the floor of an exchange should, we believe, be restricted to persons actually engaged in the trading process. Unless the public generally has free entrance to the floor of an exchange, to permit certain individuals who are not so engaged to have floor privileges sets up questionable distinctions. These distinctions, especially without a quick and reliable system for reporting transactions to the public generally, would permit persons having floor privileges to obtain and react to valuable trading information denied to investors generally. Such a situation is an element in breeding a public view that a stock market is a place for insiders and thus reduces public confidence in the integrity of the market place.

Furthermore, as noted elsewhere in this report, one of the problems facing the Indian markets is manipulation. There is no better place than the floor of a stock exchange to enter manipulative orders. It is difficult enough for an exchange to supervise the conduct of those members who have business on the floor, without having a group of non-members whose conduct has to be policed. The exchanges ought to be required to enforce strictly the rules barring outsiders from the floor. The presence of remisiers on the floor ought to be re-examined with a view to determining whether their presence serves any useful purpose.

B. Mechanics of execution

Allowing for certain technological differences and slightly different trading practices, an order entered by a public investor in India is executed in a manner quite similar to that employed on American exchanges.

Customers use orders similar to those in general use in the United States. Market orders are sometimes known as "best-rate" orders; and brokers interpret their responsibility to execute such orders "as soon as possible at the prevailing market rate," which is basically the same as the responsibility of the brokers in the American exchange markets when accepting market orders from their clients. However, the difficulty in communications in India has led to the development of other types of orders which give brokers some degree of discretion. One leading investment firm accepts an order "with appropriate limits." Under the terms of such an order the broker is given discretion to execute it at a price up to one full brokerage commission away from the price specified by the investor. As in the United States, some brokers will not accept discretion to the extent of deciding which security to buy or to sell for the customer, although they will accept orders in the alternative, which may contain a number of contingencies.

Orders are transmitted to the floor of the major Indian stock exchanges in a variety of ways. Telephone facilities are provided by the exchanges; runners may bring orders and, as was noted above, remisiers are permitted to take orders onto the floor of the exchanges.

When orders reach a member or an authorized assistant on the floor, he takes the order to the trading crowd where he will make inquiry about current quotations. The market is quoted by jobbers, known as taravaniwallas (see below for a description of the activities of these members). Although both the Calcutta and Bombay Stock Exchanges run continuous auction markets during trading hours, most transactions do not occur between brokers but between a broker acting for a customer on one side of the transaction and a taravaniwalla acting as a dealer on the other side. Since the Indian markets are currently in a period of low volume, it is not surprising that there is not a sufficient volume of orders from members of the public to insure a continuous auction market without participation by professionals. Even when public volume is high, substantial participation by taravinawalls is likely to be necessary to ensure a continuous auction market.*/

Price quotations given on the floor of the Bombay and Calcutta Stock Exchanges are understood to be good for one unit of trading, which may vary from 1 to 100 shares, depending on price. It is the English and American practice for a broker holding a customer's order initially not to reveal to a dealer whether his order is to buy or sell until he has received both a buying and selling quotation from the dealer. We were not able to wholly clarify this point but there was some indication that Indian brokers, when they were in a hurry, disclose their customers' orders before receiving quotations for both sides of the market. It would seem that to the extent that this is done it should be discontinued. A broker is not fully discharging his responsibility by disclosing his client's hand prematurely.

The trading rules of the Bombay Stock Exchange make no distinction between a customer's order and a principal transaction by a member. Thus, members are never compelled to yield priority to a public order. It is not clear the extent to which this practice permits a broker to compete with his own customers. In any event, it would seem desirable to establish a system

---

*/ On the New York Stock Exchange, specialists (who perform the function of jobbers) are involved as dealers in almost 30 percent of all transactions. See Report of the Special Study, Chapter VI.D.

of priority, under which floor trading transactions by members would be compelled to yield the floor to public orders under certain circumstances.

After a transaction is completed, it is reported to the client, first orally and, as discussed below, by a written confirmation. The next morning, so-called contract clerks representing each of the members involved in the transaction make a comparison and initial the ledger of the member involved on the other side. These initials are binding upon each member. The ledger entry is the broker's permanent record of the transaction. A memorandum is generally prepared during the day of the transaction by the executing member or his assistant who executes a transaction, but no entry is made as to the time of transaction. In any event, since the customer does not have access to a system of sequential reporting of transactions, a timed report would not enable him to determine whether his execution was proper. The lack of a timed record is, however, a limiting factor on the ability of the exchanges or the Government to reconstruct the market for surveillance purposes.

As in the United States (but not in England), Indian brokerage firms may trade with their clients as principal. We understand that the practice is fairly common in India except for certain firms which as a matter of internal practice never act as principal. Such transactions must be at a "fair and reasonable price." The "cross" will usually take place off the floor of the exchange and the pricing is generally said to be at the current exchange price. Two separate forms are prescribed for confirming transactions, one for agency transactions and the other for transactions where the member has acted as principal. Even on the agency confirmation, the broker's commission is not separately stated. Likewise, the form of confirmation for principal transactions does not separately state the mark-up charged by a broker.

One other point about trading mechanics should be noted. There is no uniform method of pricing odd-lots on the Indian exchanges.*/ There are certain jobbers who specialize in handling odd-lots and they will charge a non-uniform discount or premium for executing odd-lot orders. On the Bombay Stock Exchange, about 10-12 jobbers specialize in the odd-lot function. It is usually possible to obtain a quotation for an odd-lot in any of the stocks traded on Bombay. However, one of the leading brokerage firms in Calcutta (which is probably not dissimilar from Bombay in this respect) warns its customers that odd-lots may be difficult to handle.

It would be premature to recommend that a uniform method, like that in effect on American exchanges, be introduced for handling odd-lots on the Indian stock exchanges. While certain criticisms have been leveled against the odd-lot system on the New York Stock Exchange,**/ there is no

---

*/ An odd-lot is an order for a smaller amount than the trading unit in the particular security.

**/ See Report of the Special Study, Chapter VI.E.

doubt that the guaranteed execution of odd-lots under a uniform pricing system encourages small investors to participate in the markets. Study should be made of the feasibility of introducing an odd-lot system in India which would encourage small odd-lot investment.

C. The taravaniwalla (jobber) system

As noted above, the taravaniwalla is the key figure on the floor of the major Indian exchanges, and he participates as dealer in most transactions. On the Bombay Stock Exchange there are between 75 and 100 members acting as jobbers. These members are not registered as jobbers with the exchange and are not subject to any special capital or other requirements. In active stocks there may be as many as 10 members acting as jobbers and in less active securities there may be only one. Certain members specialize in very inactive securities and act as jobbers in a number of such stocks.

Currently in the most active stock on the Bombay Stock Exchange, Century Mills, there are eight members acting as jobbers. The vice-president of the Bombay Stock Exchange is one of these and he states that he was initially attracted to the stock by its activity. He is probably typical of other jobbers, who float from stock to stock as one becomes active and another loses its speculative appeal.

Not only is there no general regulatory structure governing the activities of jobbers */ but there are no trading rules which apply specifically to their activities. Jobbers are under no obligation to quote two-way markets

*/ Under the Securities Contracts Act, the Government has power to compel the Exchanges to regulate jobbers, but it has never done so.

and historically did not do so. Previous investigations of Indian stock market practices have been critical of the jobber system on this score. It appears, however, that on both the Bombay and Calcutta Stock Exchanges this practice has changed in recent years and that a jobber will maintain both a bid and an offer.

Jobbers are not restricted to acting as dealers. Some have clients of their own and their partners or assistants execute customers' orders in other stocks. Nevertheless, brokers seldom leave limit orders incapable of immediate execution with a jobber. Thus, while there is no legal inhibition on the Indian jobber acting as a broker, he does not accumulate a "book" of limit orders in the fashion of the American specialist.

The Indian jobber generally seeks to avoid carrying a position overnight, to minimize his risks. But in order to engage in such "daylight trading" the jobber must of necessity be forced on occasion to reduce positions and to refuse to assume any long positions in a declining market. Thus, the observation in prior studies, which was also made to us by an important exchange official, that the trading of Indian jobbers accentuates market trends is probably accurate.

This kind of trading activity would not be significant if it did not involve the jobber. As the Special Study of Securities Markets pointed out, the specialist occupies a position in the market place where his bids and offers often lead as well as reflect the trend of public supply and demand. Although long-term price fluctuations may ultimately be tied to fundamental economic factors, on a moment-to-moment or day-to-day basis dealers can have a measurable impact on the tone of the market. For example, the Indian jobbers establish the opening quotation in each security, which may have an important affect on the price trend during the remainder of the day.

The jobber's central position in the market place gives him a tremendous potential for manipulation. */ It has also been stated that certain jobbers have developed intimate relationships with the companies whose securities they trade. Such relationships have proved to be the breeding ground of certain frauds and manipulations involving specialists on the American Stock Exchange in recent years. **/ We believe that the

*/ For example, in the period of massive securities manipulations that preced the great stock market crash in 1929 in the United States, the assistance of specialists was often considered indispensable to the success of the pool operators. Some of the provisions of the Securities Exchange Act of 1934 were specifically aimed at this problem.

**/ See Staff Report on Organization, Management and Regulation of Conduct of Members of the American Stock Exchange, App. XII-A, Special Study of Securities Markets. On the general problem of relationships between broker-dealers and publicly held companies in India, see Section II of this report.

total absence of regulation of taravaniwallas represents a serious gap in the regulatory structure of the Indian markets, although as noted above, the Government and the exchanges have authority to regulate the present activities of jobbers.*/

When the question of the lack of regulation of the Indian jobber system has been raised in the past, it was urged that normal competitive factors compel jobbers to maintain quotes which accurately reflect the investment merits of the securities in which they deal. It has been argued that self-interest will insure that jobbers keep reasonably narrow markets to encourage investors to participate in the markets, so that the jobber, whose major source of compensation derives from turnover, would have greater opportunities of participation.**/ Although a large number of members act as jobbers in certain securities, it is questionable whether there is any real competition among them. A leading jobber told the authors that jobbers usually quote the same markets and only on rare occasion will a jobber cut prices competitively. Furtheremore, there is no system of priority which would give the benefit of transactions to the jobber who first interposed

---

*/ It might be noted that the London Stock Exchange recently took the first step towards the regulation of jobbers. A new Exchange rule provides that when a jobber decides to cease dealing in a particular security he must notify the Exchange in writing of his reasons for so doing. The rule furthar prohibits such a jobber from resuming dealings in securities without written notice to the Exchange.

**/ Similar arguments were made to the Congress in the course of the hearings which led to the passage of the Securities Exchange Act of 1934.

the highest bid or lowest offer. According to the same source the question of which jobber will engage in a prospective transaction will be settled "in a friendly way" between jobbers. These facts would seem to indicate that competition among market makers is at best an imperfect substitute for a regulatory approach, which defines duties and responsibilities.

If a regulatory approach is to be taken, however, it must rest on a careful study of the kind of markets maintained by jobbers and the effects of their trading on prices. As in other areas, there is no such data now available.*/ Such studies also should be directed at ascertaining the capital resources of jobbers with a view to imposing a capital requirement, as well as the formulation of trading rules which would prevent their activities from having an undue impact on prices. Finally, some routine surveillance system is indispensible for determining whether jobbers are engaging in manipulative activities on behalf of themselves or others.

We received indications that certain restrictive tax policies have a harmful impact on the ability of jobbers to perform their function. We understand that losses in the jobbing business are considered as being speculative in nature and hence are not allowed to be deducted from income as business losses. If jobbers are expected to perform the useful function of market-making, it would seem that losses attributable to the performance of this function should not be treated differently from those incurred in any other business or profession.

---

*/ On the need for additional market data, see Section V of this report.

D. Forward trading

The Indian stock exchanges have historically permitted a system of trading in securities which is unknown in most of the world's securities markets. This system known as forward trading, is in effect a futures market in securities.*/ Forward trading is permitted only in those stocks which are on a so-called "cleared" list of each exchange. Without attempting to describe all of the mechanics of the forward trading system, we should first note that the practice seems to have developed around the fact that the clearing procedures used historically on the Indian stock exchanges involve a 14-day settlement period.

Transactions entered into during any settlement period for cleared securities can be settled in a number of ways: First, transactions can be for spot delivery, in which case delivery and payment must take place within 24 hours.**/ Secondly, the transaction may be for so-called hand delivery, which requires that the transaction actually be settled within the clearing period of 14 days. Under this form of contract the securities must be delivered against full payment. Transactions in non-cleared securities listed on the Exchange must be settled on this basis or must be for spot delivery. However, the third alternative, which applies only to securities on the cleared list, may involve either an off-setting transaction by the investor prior to the closing of the settlement period and the payment or receipt of a cash difference, or a carrying forward of the transaction into the next settlement period.

---

*/ The only other exchange market where this system seems to play as prominent a role as it does in India is the Paris Bourse.

**/ The Securities Contracts Act does not apply to such contracts and they are thus exempted from the provisions of the law which require transactions in listed securities to take place between exchange members. It is said that such transactions are not numerous and present no substantial regulatory problem.

It is the latter arrangement which forms the basis of the forward trading system. In a formal sense, all contracts are required to be closed by the end of the settlement period, but in fact, through the interposition of an exchange member known as a budliwalla, who acts as a financier, a transaction can be kept open indefinitely. The budliwalla, for a fee, will assume one side of the contract, at the then prevailing market price, */ for the next settlement. Thus, a seller (who may be short) need not deliver securities, or a buyer need not pay the purchase price, until such time as he decides to close the contract. Of course, by carrying the contract forward, the short seller hopes ultimately to cover his short position at a lower price, and the buyer hopes that there will be an increase in price so that the transaction can be offset by a resale during the period in which he decides to take delivery. The system therefore permits long-term speculation at a minimal cash commitment. The closing cash payment which may only be a difference between contract and market prices is not a securities transaction at all; the seller never actually delivers securities and the buyer never makes full payment.

The cleared list contains the most active and well-known Indian companies. As noted above, these are the only securities eligible for forward trading. The rules of the Calcutta Stock Exchange provide that no securities shall be placed on the cleared list unless there is adequate public interest in the company; the company is of "sufficient magnitude and public importance;"

---

*/ At the end of the settlement period the President of the Exchange announces a price known as the make-up price, usually the last price at which the security involved has traded, which establishes, among other things, the price at which a transaction will be carried for another settlement period.

and, finally, that the company has been incorporated for at least three years.

Although there are no data on the percentage of all transactions carried forward, it is generally assumed that such trading constitutes a substantial portion of the volume of trading in cleared securities. The reason for the relative importance of forward trading is that, although the Indian markets are in a depressed state with low overall volume, certain "cleared-list" securities form the basis for intense speculative activity, much of which involves forward trading. At the time the authors were at the Bombay Stock Exchange, the stock of Century Mills was the speculative favorite and indeed it appeared that trading in this stock was responsible for a large portion of the trading on the entire Exchange.

It is the belief of the authors that the forward trading system is a cause of the lack of public confidence in the Indian securities markets. A frequently heard criticism of the markets in India is that many of the transactions are those of "gamblers." There can be little doubt that from the American point of view forward trading in securities is not an activity which is viewed as legitimate speculation.

Although there are admitted semantic difficulties involved in definitions of such terms as "investment," "speculation," and "gambling," transactions which are not consummated by delivery are not permitted on the American exchanges.*/ Dealings in options such as puts and calls are

---

*/ Short selling is the closest kind of transaction permitted on American exchanges to forward trading. A short seller, however, is not excused from making delivery on the fourth day after his sale and, in the conventional transaction, a short seller makes delivery with borrowed stock. Ultimately, the short seller must cover his position with a purchase in the market.

permitted in the United States but these are over-the-counter transactions and do not have any direct effect on securities prices on the exchanges.*/

Those who are interested in making a legitimate investment in a security in which there is forward trading, as well as those who hold the security, will find that prices are being set by persons who have no particular interest in the security but are merely enjoying a sophisticated form of gambling. Where a transaction that is carried forward is finally settled by a cash payment, it does not even give a legitimate investor the incidental benefit of added liquidity to the market.

It is frequently argued that the kind of speculation represented by forward trading has the stabilizing effect of evening out long-term price movements, since the informed speculator will sell short when prices are too high and will buy when they are too low. It has been the American experience that actual market data do not bear out this assumption. Such data have shown that the speculator follows the trend of the market more often than he anticipates it. If this is the case in India, the effect of forward trading would be to accentuate rather than to counteract market trends.

Furthermore, the forward trading system complicates and confuses the regulatory pattern. The discouragement by the Reserve Bank of India of banks lending to finance securities transactions, noted in Section I, seems to be aimed principally at reducing the intense speculative activity

---

*/ It is interesting to note that the Indian Securities Contracts Act prohibits dealings in puts and calls. In light of the permitted forward trading system, this prohibition does not seem to place any effectual curb on speculation. It might also be noted that the American exchanges prohibit trading in puts and calls on their floors.

based on forward trading which characterizes the market even in its present depressed state. Unfortunately, this attempt to strike at excessive speculation has the effect of discouraging all securities activities.

Another confused pattern of regulation involves the margin system. The Indian authorities apparently assume that market operators who engage in forward trading will seek to protect their positions by manipulative activities. In order to curb such activities, one of the margin requirements imposed by the exchanges at the request of the Government requires that the holder of an "open" contract to buy securities post margin when the price of the security involved has <u>increased</u>, and similarly requires the holder of a contract to sell deposit margin when the price has <u>decreased</u>. The purpose of these requirements is to prevent speculators from using their unrealized profits to force the favorable trends to continue. Margin requirements are directly opposite in the United States, where a buyer on margin must, under exchange rules, post additional collateral when the value of pledged shares decreases. The purpose of this requirement is to prevent a market collapse and broker insolvencies through forced liquidations. The Indian margin system is probably ineffective as a control of forward trading.

Furthermore, the forward trading system encourages the existence of an illegal curb market, which is discussed in the next section; discourages investors from participating in the securities markets, by perpetuating their reputation as gambling casinos; and tends to inhibit the growth of a responsible broker-dealer community. The forward trader is more interested in obtaining a fractionally lower cost for each transaction rather than in making sound investments through a qualified broker-dealer.

The authors recommend that consideration be given to measures for prohibition of forward trading in securities on the Indian stock exchanges. While such a prohibition would represent a profound change in the securities markets, it would not be an entirely new departure; forward trading was banned during the recent period of armed conflict with communist China. Abolition of forward trading in securities cannot be expected to be a panacea for all the ills which plague the markets. It may, however, be an essential step in converting the markets from a high speculative medium to a trustworthy device for channeling savings into equity securities.

E. Curb markets

A problem which has plagued the stock exchanges in India is the existence of curb markets existing in close proximity to the stock exchanges. Although the law prohibits transactions in securities in the area of the exchanges between other than exchange members (except for spot contracts), many of the participants in the curb markets are not members of exchanges. Although the rules of the exchanges prohibit exchange members from dealing in the curb markets, a number of members in fact engage in such activities. Thus, non-member brokers violate the law and exchange members violate exchange rules when they participate in the curb markets.

At the time the authors visited the Calcutta Stock Exchange the curb market was open and notorious with hundreds of persons congregating in the street immediately outside the Exchange. Although officials of that exchange represented that the trading which took place there was in commodities, it seemed to be generally recognized that much of this trading was in fact in securities traded on the Calcutta Stock Exchange.

In Bombay the curb market was not so obvious. Apparently, sometime during 1964, 100 members of the Exchange petitioned the Exchange to put an end to the curb market and the Exchange responded by announcing that any member caught participating on the curb would be subjected to disciplinary sanctions. However, exchange officials stated that the local Bombay police were not cooperative in putting an end to such activity.*/ Although the Exchange has made some progress in its drive against curb trading, it has no control over the non-members who engage in such activity.

Curb trading takes place from about 11 a.m. until 12 noon; "recesses" during the period that the exchanges are open and recommences about 2 p.m. until 5 p.m. Thereafter a telephone market, which may be completely lawful when conducted by exchange members, is maintained by a handful of brokers. In Bombay, the newspapers regularly publish 9:30 or 10 p.m. quotations in listed stocks. It has been stated that these quotes are often artificial ones but have a profound effect on the course of trading on the Exchange the next day.

Opinions vary as to why the curb market exists, although almost every person interviewed regarded the existence of these markets as a major problem. It seems somewhat anomalous that such an active curb market can

*/ In fact, the President of the Bombay Stock Exchange received a traffic ticket when his chaffeur used his horn in an attempt to clear a path in the street. The stock exchanges and the central government lack the resources to combat curb trading.

exist in a period of depressed prices and low volume. Historically, in the United States such markets existed during periods of boom and disappeared when the markets were depressed. One suggestion which seems to have merit is that these curb markets are intimately connected with the forward trading system. Since the official markets are open only two hours, the kind of speculator who is interested in the "gambling" aspects of forward trading cannot find enough "action" and simply move into the streets when the exchanges are not in session. A partner in an important investment-oriented firm stated that a broker could not avoid participating in the curb market if he accepted clients who engaged in forward trading. Since fluctuations in curb market prices affect exchange prices, a broker carrying forward positions is forced to participate to protect his client's interest.

Another fact which may help explain the existence of the curb market is that there is no minimum commission rate schedule in effect on the exchanges. Thus, persons desiring to engage in the business do not have the incentive of price protection as quid pro quo for submitting to regulation by the Exchange and payment of the required fees. Likewise, members themselves do not have the common interest in protecting the exchanges that price protection would provide.

It would seem obvious that a totally unregulated market run by persons not subject to any regulatory jurisdiction and which affects prices on the official markets presents a problem of the first magnitude--especially when it seems to be generally accepted that these markets are manipulated. Furthermore, the existence of such markets can only detract from the exchanges' ability to control members'activities in their own market places.

Regulatory controls imposed by the exchanges or the Government will only tend to weaken the exchanges' competitive position to the benefit of the unregulated curb markets. It would appear vitally necessary that any regulatory program aimed at improving the character of the official market must be paralleled by a vigorous program to eliminate curb trading. Another possibility, which standing alone would not solve the problem, is to increase trading hours on the recognized exchanges.

F. Blank transfers

An area which has excited much attention in recent years among persons interested in the Indian securities markets is that of so-called blank transfers. This is a method by which name of the buyer is omitted from the deed of transfer when ownership of securities is transferred. The securities subject to a blank transfer may pass from hand to hand for a considerable period before some purchaser fills in his name and has himself registered by the company as a shareholder. At first blush this system is merely a commercial convenience analogous to the common American practice of leaving securities in "street name," i.e., in the name of a nominee of a brokerage firm. Both systems minimize the paperwork necessary in transferring securities on the records of the company as a result of every purchase and sale or other transfer of beneficial ownership.

The Indian blank transfer system has come under recurrent attack at least since 1924, when it first came under scrutiny, and legislation is currently pending which would restrict the life of a blank transfer to six months. The reasons for these attacks is that blank transfers have been abused in several respects. First, a blank transfer facilitates manipulations and questionable transfers of securities between corporations and insiders for unlawful purposes. Secondly, the failure of the transfer records of a corporation to reflect the actual beneficial owner of stocks enables the system to be used to evade income taxes and conceal wealth. Thirdly, blank transfers are used to avoid transfer taxes. Finally, the blank transfer has come under attack because it is an important if not essential mechanism in forward trading. As was noted above, a forward trading contract is theoretically closed at each settlement, although in fact the position may be carried over indefinitely. If it were not for blank transfers, forward traders would be forced to register a transfer of securities at the close of each settlement period.

The stock exchanges have attempted to resist the imposition of new controls on blank transfers. They argue that further restrictions would inhibit the liquidity and negotiability of shares by affecting credit facilities and disturbing banking practices. They urge that additional legislation should be aimed not at restricting the blank transfer system but at increasing the protection afforded to holders of certificates under a blank deed of transfer so that these such certificates achieve something like the status of a fully negotiable instrument and can be held free of various common law defenses.

It seems to the authors that the attack on the blank transfer system is at least in part misdirected. None of the evils, except perhaps the avoidance of transfer taxes, flow directly from use of the system. Even if this system were eliminated or severely circumscribed, other devices to achieve the same result would probably develop. Where shares are freely traded and widely held, there is a commercial need for legal devices which enable securities to pass from hand to hand with as little red tape as possible. If the blank transfer system were restricted to such an extent that it would not serve this purpose, the use of nominee names might well take its place. If this or some similar development were to take place, the transfer records of a corporation would be just as difficult to use for the purpose of identifying beneficial ownership as under the blank transfer system.

Nevertheless, the problems are real ones. At least part of the answer might lie in a requirement that all brokerage firms "know" their customers and to keep adequate records of their identity and transactions. If it were unlawful for a broker knowingly to accept an account where the principal was not revealed to him and for anyone to deal with a broker without revealing the identity of the person or persons having a beneficial interest in the account, the problem would be ameliorated to an extent. Under such a rule, the broker's office rather than the books of the corporation would be the focal point for information concerning the current status of a corporation's securities. Of course, this would not solve the problem of direct transfer without the use of a broker, but even a prohibition on blank transfers would not prevent the use of secrecy and false identification by those willing to violate the law. */

*/ The answers to the specific problems of concern which involve misuse of blank transfers might be found in their own context. For example, for tax purposes a transfer could be presumed in law to have taken place when first reflected on the books of a corporation, with the taxpayer required to prove that there was a beneficial change in ownership at an earlier date.

IV. NEW ISSUE PROBLEMS

It is beyond the scope of this report to describe and evaluate the procedures used for the distribution of new issues of securities in India or for the regulation of such distributions. Nevertheless, it seems appropriate to include in a report on the problems of the Indian stock exchanges a brief discussion of the new issue boom that existed between 1959 and 1962 and the problems to which it gave rise. For one thing, although new issues are not distributed through the medium of the stock exchanges, members of the exchanges act as brokers or underwriters in distributions, and listing on an exchange usually follows the distribution of a new issue by no more than a few weeks. Thus, the rules and policies of the exchanges have important effects on the new issue market and vice versa. Secondly, there can be little doubt that the excesses and misconduct that apparently occurred in the new issue market during its heyday are a cause of the present lack of investor confidence in the Indian securities markets generally, which extends to the trading markets on the stock exchanges. Any measures taken to repair that confidence would probably need to include protections for customers in the new issue market.

Between 1959 and 1962 something of a speculative fever seems to have struck the Indian investing public.*/ During this period the

---

*/ A similar phenomenon occurred in the United States during the same years. The American new issue boom is described in Chapter IV of the Report of the Special Study of Securities Markets.

public was eager to buy the securities of almost any new company - in one instance the public oversubscribed a new issue by 64 times the amount of stock that was being offered. We were told by one broker that he received more than 1,000 requests to subscribe to many new issues, from cab drivers, vegetable vendors, and other persons who had never before invested in securities. Many of these stocks, after initially trading at a premium, suffered substantial price reverses, and a recent survey indicates that approximately 75 percent of all new issues offerred to the public during these years are now trading below par value. Many persons, particularly unsophisticated investors, lost money from speculating in the new issue market and are consequently reluctant to reenter the securities markets today.

The price fluctuations which characterized the new issue market appear sometimes to have been created or influenced by manipulative activities on the part of corporate insiders. In some instances, stock was withheld from the market to restrict supply, while rumors and misleading information were disseminated to increase demand. Then, while a high price level was maintained by these methods, the insiders would sell out their shares to the public. In some instances, the trading market commenced at premium prices before the distribution was completed, and we heard of one case in which trading began before the company was even organized! Some promoters created a scarcity of stock by withholding application forms for allotments, with the result that eager investors offered payment for the forms themselves. The Government finally required that a reasonable number of forms be distributed in any new issue. Such devices not only created artifically high trading premiums but also prevented public investors from selling their allotments until the insiders had already sold their stock and the price had gone down.

Government regulation of the distribution of new issues of securities has been concerned principally with directing capital into approved channels in accordance with overall economic policy. Protection of investors against fraud and manipulation did not receive major emphasis, at least until the excesses during the new issue boom pointed unmistakeably to the need for regulation in this area. Certain of the reforms which were effected during this period were supported by the stock exchanges, principally the Bombay Stock Exchange. An example, is the requirement imposed by the Government that at least 49 percent of any new issue be distributed to the public; this requirement had for some years been a condition to listing on the Exchange. The Government also prohibited insiders from selling their allotments of new issues for a period of two years. Both of these measures probably reduced the manipulative potential in distributions of new issues.

Present Government regulation of new issues is chiefly the responsibility of the Controller of Capital Issues. This official reviews the prospectuses of companies intending to issue securities to the public in order to ascertain whether they contain the information required by law.

This review does not appear to be as comprehensive as that of the Securities and Exchange Commission in the United States; for example, the Controller of Capital Issues does not check the wording or the reasonableness of estimates by a company of its future earnings or progress. The Controller of Capital Issues also reviews prospectuses for compliance with other requirements. One of these is the limitation placed on promotional costs, including payment of promoters, underwriters, and brokers. These expenses may not be in excess of 5 percent of the total offering.

The Controller of Capital Issues also sets the offering price of certain new issues. In a number of instances this price, which is worked out through a rather complex formula, represents a premium over the par value of the stock. Several brokers indicated dissatisfaction that they were required to sell new issues at a premium, especially since the later decline in the price of the stock caused substantial losses to investors. One of these brokers told us that he no longer recommends new issues to his customers because of their past poor performance, especially as compared to the premium prices that he was obliged tocharge.

We recommend that the requirements applicable to new issues and their administration be reviewed for the purpose of strengthening the protections afforded to investors and also to remove any unnecessary restrictions on underwriters or brokers. In connection with the latter, it may be that the limitations on compensation are too restrictive in the light of the risks and expenses involved, and that they serve to discourage broker-dealers from participating in offerings of new securities. Furthermore, we understand that these limitations are evaded by some underwriters, who charge companies additional "consulting fees." These considerations will of course have to be weighed against the Government's interest in channelling the maximum amount of capital into productive uses and in preventing overreaching by broker-dealers.

V. DISCLOSURE REQUIREMENTS

The availability of adequate and accurate information concerning companies whose shares are publicly traded is essential to a public market in securities. The listing agreement, to which all companies whose shares are admitted to dealings on an Indian stock exchange are required to subscribe, contains a number of disclosure requirements. Our survey revealed certain inadequacies both in the requirements themselves and in their enforcement. Furthermore, it is possible that the Government should assume a larger role in assuring adequate disclosures to the public.

The listing agreement adopted by the exchanges has been approved by the Government under the Securities Contracts Act. It applies not only to newly listed companies, but also to those which were already listed at the time of its enactment. The agreement contains several provisions with regard to disclosure, as follows:

1. Every listed company must file with the exchange, as soon as they are issued, its annual report, balance sheet, and profit-and-loss statement. (The Companies Act requires that these reports be furnished to stockholders). Copies of these reports must be furnished, upon application, to any member of the exchange.
2. A schedule of the distribution of its securities and the names and holdings of the ten largest

stockholders must also be filed annually with the exchange.

3. The exchange may require interim statements of earnings and operations, but only with the consent of the company.
4. Declarations of dividends must be reported immediately to the exchange, together with a profit-and-loss statement for the year and a comparison with the previous year.
5. Changes in a company's capital structure; the general nature of its business; and its officers, directors, or auditors must be reported promptly to the exchange.
6. Prompt notice must also be given to the exchange of "any other information necessary to enable the holders of the listed securities of the company to appraise its position and to avoid the establishment of a false market in such listed securities."
7. Such other information must be furnished as the exchange "may reasonably require."
8. The exchange may disclose any of the above information to the press or its members. Provision is made, however, for confidential treatment where public disclosure would be detrimental to the company.

9. Proxies must be solicited for all but routine matters to be presented to the stockholders, and questions must be so worded that a stockholder is able to vote either way.

These requirements cover a good deal of ground and could provide the basis for a reasonably adequate system of corporate disclosure. Nevertheless, we received a very distinct impression that stockholders actually receive considerably less corporate information than a reading of these requirements would indicate.

Although periodic reports are contemplated by the listing agreement, the exchanges do not require them if the company does not wish to file such statements. At present, tea and coal companies issue quarterly statements of earnings, while the two principal steel companies publish monthly production figures. Such companies, however, are in the minority. The provision in the listing agreement giving an exchange the right to require the furnishing of additional information has been very seldom invoked; the Calcutta Stock Exchange has never done so, the Bombay Stock Exchange only once. It appears that when this provision was adopted it was informally understood that the exchanges would not request information except by mutual consent.

More serious than these shortcomings of the disclosure requirements is the fact that the exchanges do not have the necessary staffs to scrutinize the reports when they are filed or to obtain compliance by delinquent companies. We were informed that reports of some companies are unreliable and that delinquency in filing is not at all unusual. Although an exchange has the power to suspend trading in a security where there is a lack of required information, this has apparently been done in only one instance, where a company whose securities were listed on the Bombay Stock Exchange effected a sale of assets without notifying the exchange. Public companies are also required to file annual financial statements and certain other information with the Registrar, a Government official, and these filings are available to the public. They apparently are not reviewed for the accuracy of the corporate information and estimates contained in them.

For purposes of comparison, it may be noted that listed (and certain unlisted) companies in the United States are required to file with the Securities and Exchange Commission and the exchanges on which their securities are listed, audited annual financial statements, interim financial statements, and reports of important corporate changes; and there is comprehensive regulation of proxy solicitation. This material is reviewed by the Commission staff, and misstatements or material omissions may be the basis for criminal or injunctive proceedings, or in general for civil actions by private investors. Beyond these legal requirements, the exchanges have additional requirements, such as for the prompt disclosure of dividend and other important corporate information and the publication of quarterly earnings statements.

The pattern of disclosure that exists today in the United States is the result of efforts over the past hundred years by the Government, the New York Stock Exchange, and others to alter the traditional habits of secrecy that once prevailed in the business community. It may be that there is a close connection between the availability of reliable information concerning companies and the broadness of the base of public interest in securities. A similar process of converting businessmen toward acceptance of the desirability of disclosing corporate information seems to be taking place in India today. We understand that while certain business groups in India have resisted giving the stock exchange financial information, others have recently altered their policies in favor of fuller disclosure.

In January 1964, the Government brought to the attention of the Bombay Stock Exchange the importance of regular dissemination of information by public companies. The Government urged that companies be invited to issue periodic progress reports including information on production, output, sales, labor relations, and expansion programs; and it pointed out that detailed periodic reports are required in the United States. The availability of such information, the Government stated, would cultivate a closer relationship between a company and its stockholders, create personal interest in the working of the company, and provide a sound basis for making investment decisions and for evaluating investment results. The Exchange replied that the question would receive consideration but did not indicate any willingness to require listed companies to publish periodic reports.

Nevertheless, the Indian exchanges, particularly the Bombay Stock Exchange, have taken the lead in inducing listed companies to provide more information to the public. The Bombay exchange has in preparation a statistical service covering all publicly held companies, not restricted to those listed on the Bombay Stock Exchange. Other exchanges publish official yearbooks, which contain information concerning the financial condition, management, corporate structure, and operations of listed companies. These projects should be encouraged by the Government in every possible way.

We recommend that further study be made of additional methods by which the Government can increase the quantity and reliability of corporate disclosures. Among the possibilities are the enactment and enforcement of legal sanctions, including provisions for private causes of action by investors, for misstatements or material omissions in required reports to exchanges, and the exploration of methods by which broker-dealers, banks, and other financial institutions could insure the maximum dissemination of corporate information. We think that the Indian stock exchanges should continue to bear the primary responsibility for insuring adequate corporate disclosure. It would be desirable to increase to the extent possible the staffs of the exchanges engaged in review of corporate information and the enforcement of the relevant requirements.

The exchanges are hampered in enforcing requirements applicable to listed companies by the fact that the only effective sanctions that they can impose are the drastic ones of suspension or delisting. Unfortunately, these sanctions may harm innocent stockholders. (This is especially true in India, where no real over-the-counter market exists). Furthermore, once a company is delisted it is of course no longer subject to any regulation by an exchange. It has been suggested that the exchanges each establish two stock lists. One would include larger, well seasoned companies, while the other would include smaller and newer companies, which would have to comply with lesser requirements. Failure by a company on the first list to comply with exchange rules applicable to it would lead to transfer to the second list. The public would be informed that investment in securities on the second list would involve greater risks, and perhaps broker-dealers would not be permitted to recommend or sell such securities to certain categories of investors (e.g. trusts, minors, discretionary accounts). Without necessarily endorsing such a plan at the present time, we recommend that it be further explored.

In addition to corporate disclosures, there is a very real need for reliable data concerning the Indian securities markets themselves. The importance to investors of daily volume figures for each security traded on the exchanges has been referred to in a previous section of this report. Furthermore, information concerning the trading of various kinds of investors might be valuable to the Government and the exchanges in the performance of their surveillance and regulatory responsibilities, even though it would not necessarily be made public. For example, a statistical study of the trading of jobbers and other exchange members for their own account might provide the basis for certain kinds of regulation of these activities. Without such information, it might be difficult to ascertain whether regulation would be in the public interest. Such trading studies should be among the first steps taken in any program for the improvement of the Indian securities markets.

VI. THE REGULATORY PATTERN

Indian securities regulation is based in large part upon the concept of self-regulation. In 1951, the Gorwala Committee, which had been appointed by the Indian Ministry of Finance to make proposals for the regulation of the Indian stock exchanges, made the following recommendation:

> "Ordinarily, it should not be necessary for Government to interfere in the internal working of the exchange. Within its own sphere, the exchange should have a large measure of autonomy and Government's role should be limited to keeping in touch with happenings on the exchange and ensuring that it enforces its bye-laws properly."

The recommendations of the Gorwala Committee formed the basis for The Securities Contracts Act. As stated earlier in this report, this statute gives the Government rather far-reaching powers over the stock exchanges.

The United States, like India, is committed to a system in which the primary duty of regulation of the stock exchanges is borne by those organizations themselves. The Special Study of Securities Markets came to the conclusion that this system of self-regulation, despite certain flaws, had proved its worth during its 30-odd years of existence. There seems to be no reason why self-regulation should not be equally effective in India. Moreover, the alternative of direct regulation by the Government would tend to be somewhat inflexible, administratively burdensome, and expensive.

An important feature of the American self-regulatory system is the fact that the Government has certain direct powers in reserve. The Securities and Exchange Commission not only has similar powers to those of the Indian Government to take action against an exchange, but it also can if necessary act directly against broker-dealers, including exchange members, to stop or punish fraudulent activity, suspend or expel members from exchanges, control lending and hypothecation of securities, and supervise the trading of exchange members for their own account. It seems likely that such powers, which Justice William O. Douglas (a former Chairman of the Commission) once referred to as "the shotgun behind the door," contribute to the success of self-regulation, assuming that the Government is willing to employ them should the necessity arise. It is recommended that consideration be given to the possibility of providing the Indian authorities with statutory authority to take direct action where the stock exchanges are unable or unwilling to fulfill their responsibilities as self-regulatory organizations.

The other essential Governmental role in a system of self-regulation is that of overseer of the self-regulators. The task of oversight in India is performed by the Stock Exchange Division, which is part of the Company Law Board. At present it is composed of only two professional persons, the Director and Deputy Director of Stock Exchanges. The former makes Bombay his headquarters, while the latter is located in Calcutta. With eight exchanges to supervise, this skeleton staff can do little more than act as observers. Nevertheless, in their capacity as the Government nominees on the governing boards of the exchanges, they have apparently been able to exert some influence.

It is strongly recommended that steps be taken to build an adequate, albeit still small, professional staff, including lawyers, accountants, and economists, for the purpose of providing oversight of exchange self-regulation. Such a staff, which need not number more than a dozen or two persons exclusive of clerks and stenographers, if composed of capable individuals would be able to enforce the Government's existing powers, as well as any additional powers, such as those recommended above, which might be eventually adopted.

The stock exchanges themselves have at best rudimentary systems for self-regulation. In this respect, the Bombay Stock Exchange is in a class by itself, but even Bombay is below the standards of the major American exchanges. The Bombay Stock Exchange is unique (so far as India is concerned) in having a full-time paid president, K. R. P. Shroff. Mr. Shroff who has held his post since 1923, is an eminent figure in India financial circles, to whom the Government has on occasion come for advice and assistance. Aside from Mr. Shroff, the regulatory staff consists principally of the secretary and assistant secretary of the Exchange. The Calcutta Stock Exchange has no formal regulatory staff, although it has a few employees who devote their time to research, statistics, and public relations.

For the purpose of building well-trained regulatory staffs for the Government and the major exchanges, it might be desirable for selected individuals to undergo a limited period of training in securities regulation in the United States at universities, the Securities and Exchange Commission, and the stock exchanges.

Management of the exchanges and regulation of members therefore rests in the hands of their governing boards. The membership of the governing boards, at least in Bombay and Calcutta, is largely composed of representatives of speculative firms. Not one of the investment brokers to whom we spoke was a member of the governing board of an exchange. They all stated that their views would not be popular among the other members of the board or that they would "feel like a fish out of water." One such broker stated that he had not been reelected to the board of the Calcutta Stock Exchange after he had expressed views critical of the management of the Exchange.

It thus appears that the brokerage firms that have the most contact with the investing public and are likely to be most responsive to its interests have little if any voice in guiding the destinies of the exchanges or in regulating the conduct of their members. Representatives of both Government and industry described the governing boards of the exchanges as private clubs in which the speculators made rules favorable to themselves and were not interested in regulating the conduct of each other or of other members. It seems probable that if this view is generally held by the investing public, it greatly contributes to the present lack of interest in investing in Indian securities.

It should be observed that there may be a close relationship between the problems of management and membership of the exchanges and the commission rate structure, discussed in an earlier section of this report. Where a minimum commission rate exists and is enforced, there is a strong incentive for investment bankers, brokers, and others who do business with the public (and even certain large investors) to become exchange members in order to avoid the necessity of paying the full nonmember commission. Where there is no minimum rate the only persons who are under an economic necessity to be exchange members are individual brokers who execute orders on the floor of the exchange, many of whom have little direct contact with the investing public. As we have seen, these members appear to control the management of the Indian stock exchanges.

In attempting to raise the standards of the Indian securities industry and to transform the exchanges into truly self-regulatory organizations, ways should be explored to ensure a larger role in exchange government to firms doing business with the public, and to make membership attractive to persons and institutions which are outside the exchange community at the present time, perhaps including banks. Among the measures that might be used to achieve this result are the reservation of a certain number of seats on exchange governing boards for persons representing institutions and firms doing business with the public, and the restoration of a minimum commission rate.

VII. CONCLUSIONS AND RECOMMENDATIONS

Throughout this report a number of recommendations have been made which, if fully implemented, would ultimately involve major structural changes in the regulation of the Indian stock exchanges. These recommendations should not be viewed as hard and fast proposals, but rather as areas for further study.

These recommendations are all based on the assumption that it is the purpose of the Indian Government and the financial community to broaden the base of investment in India. We firmly believe that the markets and the regulatory pattern must be oriented in a direction which would serve the needs of the small non-professional investor.*/ It has been our experience in the United States that full disclosure and fair markets staffed by skilled professionals under an adequate regulatory program are absolute prerequisites for investor confidence. Furthermore, it would not be a responsible course of action to invite the small investor into a market place which did not contain certain fundamental protections.

These recommendations add up to a substantial program. Although some of them may not be susceptible of immediate implementation, we believe that within the confines of the program set forth below, foundations can be laid for all of the recommendations ultimately deemed worthy of adoption.

---

*/ In this connection there is one possible course of action to achieve this purpose which is not discussed in the text and strictly speaking is not within the scope of this report. One method of channelling savings into securities would be to encourage the growth of professional intermediaries other than broker-dealers. The Government's sponsored unit trust, discussed in the report, represents a step in this direction. The possibility of encouraging the establishment of similar private mutual funds might well be a subject for study.

The Government of India originally requested that two consultants go to India for a period of six months. It was suggested that one of these consultants might be a person from the Securities and Exchange Commission and the other a member of the staff of one of the American stock exchanges. On the basis of our survey of conditions in the Indian securities markets, we think that the latter part of the request is premature. The present need is for fundamental structural revision of the regulation of the markets and not for the technical or operational assistance which exchange officials might be able to provide. At some future time, however, it might be appropriate that an official of one of the American stock exchanges be invited to serve in a consulting capacity.

As we see it, an optimum program would be for one official of the Securities and Exchange Commission to spend approximately one year in India as a consultant. If a qualified official cannot be made available for a sustained period of this length, an alternative would be for such an official (or officials) to go to India for shorter periods aggregating the same period of time. The purpose of this mission would be first to consult with appropriate persons about the desirability of implementing each of the tentative recommendations set forth in this report; to conduct further studies in the areas covered by the recommendations; and, finally, to assist in their implementation.

The recommendations contained in this report cover such broad territory that it would be desirable that the person or persons selected for the mission have a broad background and experience in the formulation and administration of the Securities and Exchange Commission's regulatory programs. However, even assuming the availability of such a person, some of these areas covered require the application of specific skills which are possessed by certain specialized persons on the staff of the Commission or in private industry. It is therefore recommended that in addition to the consultant three other persons also be sent as special consultants for approximately six weeks each: one economist with experience in data collection and market studies; one attorney or analyst familiar with corporate disclosure requirements and practices; and one accountant familiar with brokers' books and records and margin procedures. If the need should later arise for experts in other fields, such as that of mutual funds, provision might be made for visits by such persons. It might also be advisable for one senior Securities and Exchange Commission official to go to India for a short period at the inception of the program with the consultant to aid in the setting of priorities and the allocation of Commission personnel. It is envisaged that the full program will be scheduled at the conclusion of these initial discussions.

The major tentative recommendations of the report are summarized below:

The Broker-Dealer Community

1. The use of inside information in securities transactions to the detriment of the investing public, as much as any other single abuse, is destructive of public confidence in the integrity of the market. The Government should be given direct powers over trading by corporation insiders, including broker-dealers.

2. The competence, ethics, and regard for the law present in a securities market can rise no higher than the quality of its broker-dealers. A study should be made of the qualification of broker-dealers, with a view to raising the present standards, either by the Government or the exchanges, and possibly the imposition of an examination requirement for persons wishing to enter the securities business.

3. The present record-keeping requirements applicable to broker-dealers should be reviewed and consideration should be given to the institutions of spot-check examinations of their books and records, preferably on a surprise basis, either by Government or exchange auditors.

4. Steps should be taken to provide an economic atmosphere in which an efficient broker-dealer can earn a reasonable return on his capital and services without being subject to undue risks. Among the possible steps to accomplish this that should receive consideration are the following:

(a) the establishment of a minimum commission rate, subject to review by the Government;

(b) a requirement that customers be required to deposit with their brokers any margin that brokers are required to deposit with an exchange clearing house; and

(c) allowing broker-dealers to advertise and solicit business under certain conditions and with necessary restrictions, including the adoption of rules and procedures by the Government and Exchange to ensure accuracy and high quality of any material distributed.

Trading Practices

1. Volume information by stock should be collected and published daily by each exchange. Such information is useful to the public investor in determining whether price movements reflect any widespread re-evaluation of the investment merit of a particular security, and to the regulatory authorities for market surveillance purposes.

2. Present exchange rules restricting access to the trading floors should be strictly enforced and study should be given to the feasibility of prohibiting entry to the floors of all persons except members and authorized assistants. The presence of outsiders and securities salesmen on an exchange floor presents difficult regulatory problems in view of the potential for manipulation which access to a trading floor carries with it.

3. Trading rules should be developed which would ensure that brokers on the floor executing public orders obtain the best possible execution for their customers. A public order should

generally be given priority, over member orders originating on the floor.

4. As a possible means of encouraging the smaller investor to participate in the securities markets, a study should be conducted to determine whether it would be appropriate to introduce a uniform system of pricing odd-lots.

5. The role of the taravaniwalla, or jobber, is critical to market continuity and liquidity. Jobbers are also in a unique position to engage in manipulation or other detrimental market activities. Studies should be conducted of the operations of the jobber system on the Indian exchanges to determine the market effects of their trading activities for the purpose of developing an adequate regulatory program. Tax policies which do not allow jobbing losses to be treated in the same fashion as ordinary business losses should be reviewed.

6. The system of forward trading in securities on the Indian exchanges seems to be a major factor in current public distrust of the markets. Forward trading not only complicates the regulation of broker-dealers but also may inhibit the flow of credit to legitimate investors. It is recommended that study be given to the feasibility of eliminating forward trading.

7. Curb trading is a phenomenon which exists in defiance of law and of exchange rules. It is totally unregulated and harms the recognized exchange markets. Unless vigorous steps are taken to eliminate the curb markets, any program of reform aimed at improving the regular markets will merely encourage the growth of unregulated curb trading.

8. The system of blank transfers of securities has been attached as facilitating manipulation and other kinds of undesirable conduct by making it difficult to determine beneficial ownership of securities from corporate transfer records. Blank transfers nevertheless seem to serve a useful commercial purpose. It is recommended that alternative methods for securing such information be developed, such as requiring that brokers' books and records reflect beneficial ownership of securities in each account.

<u>New Issue Problems</u>

1. Speculative excesses and possibly manipulative activity that occurred during the new issue boom of 1959 to 1962 are one of the causes of the present lack of investor confidence in the Indian securities market. The requirements of law and exchange rules applicable to new issues and their administration should be reviewed for the purpose of strengthening the protections afforded

to investors and also to remove any unnecessary restrictions on underwriters or brokers.

Disclosure Requirements

1. The availability of adequate and accurate information concerning companies whose shares are publicly traded is essential to a public market in securities. Study should be made of methods by which the Government can increase the quantity and reliability of corporate disclosures, including the enactment and enforcement of legal sanctions for misstatements or material omissions in required reports to exchanges, and the exploration of methods by which broker-dealers, banks, and other financial institutions could insure maximum dissemination of information. The stock exchanges should continue to bear the primary responsibility for insuring adequate corporate disclosure, and their staffs should be strengthened for this purpose.

2. As part of this program, the Government should encourage in every way the efforts by the exchanges to disseminate corporate information.

3. For companies which cannot meet the present exchange listing requirements, delisting may not be feasible, because there is no organized over-the-counter market in India. The possibility of dividing companies admitted to trading on exchanges into two lists, with different requirements for each, should be explored.

The Regulatory Pattern

1. Consideration should be given to the possibility of providing the Government with statutory authority to take direct action against broker-dealers where the stock exchanges are unable or unwilling to fulfill their responsibilities.

2. Steps should be taken to build an adequate, professional staff, including lawyers, accountants, and economists, for the purpose of providing oversight of exchange self-regulation.

3. Ways should be explored to ensure a larger role in exchange government to firms doing business with the public, and to make membership attractive to persons and institutions which are outside the exchange community at the present time.