

**REPORT OF THE US SECURITIES AND EXCHANGE COMMISSION (SEC) TO THE
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID) CONCERNING
TECHNICAL ASSISTANCE TO INDIA UNDER THE FINANCIAL INSTITUTIONS
REFORMS AND EXPANSION PROJECT, PHASE II**

**PASA NUMBER 386-P-00-01-00087-00
PROJECT NUMBER 386-0531**

FOR THE QUARTER ENDED September 30, 2005

The SEC provides technical assistance to India pursuant to a Participating Agency Service Agreement (PASA) with USAID dated May 4, 2001. This report describes the SEC's activities under the PASA for the quarter ending September 30, 2005.

ACTIVITIES DURING THE QUARTER

During the quarter, James Clarkson continued to provide the SEBI with technical assistance regarding enforcement. As part of this effort, Mr. Clarkson participated in a video conference with the SEBI's Expert Committee on Enforcement Policy and Procedures regarding implementation of certain recommendations suggested in the report on SEBI's Enforcement Program prepared by Mr. Clarkson and Paul Gonson.¹

The SEC presented to USAID and SEBI a Work Plan for September 1, 2005-December 31, 2006, the end of the current PASA (*see* attached copy).

REIMBURSABLE SEC STAFF TIME AND EXPENSES

The following SEC staff member rendered reimbursable assistance during the quarter:

James Clarkson, Office of Enforcement	31 hrs.
Ester Saverson, Office of International Affairs	16 hrs.
Total	48 hrs.

¹ At the request of USAID and the Securities and Exchange Board of India (SEBI), James Clarkson, SEC Director of Regional Office Operations in its Division of Enforcement and Paul Gonson, former solicitor for the SEC, conducted an on-site assessment of the SEBI's enforcement program in March 2005. The team produced a report that included recommended changes to the SEBI's enforcement program. Copies of the report have been delivered, respectively, to USAID and the SEBI.

Based upon the composite hourly rate of \$95.14 per hour, as established under the PASA, the SEC's reimbursable staff time charges incurred during the quarter were \$4,566.72. Overall G&A expenditures for the quarter were \$685. Accordingly, the SEC will submit a claim for reimbursement of \$5,251.72 under the PASA (See the attached financial report for additional details).

November 2, 2005

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Dr. Robert M. Fisher". The signature is written in a cursive style with a large initial "R" and "F".

Dr. Robert M. Fisher
Assistant Director
Office of International Affairs

Financial Report

September 1, 2005

WORK PLAN UNDER THE PASA BETWEEN USAID/INDIA AND SEC
(September 1, 2005-December 31, 2006)

Prepared by

SEC's Office of International Affairs

Submitted to

USAID/New Delhi India
PASA Number 386-P-00-01-00087-00

General Information

This Work Plan is based on the PASA between the USAID and the SEC. The Work Plan is for 16 months (September 1, 2005-December 31, 2006). All work is contingent upon counterpart good faith co-operation and availability for participation in the technical assistance and training programs. The "Status/Comments" section under each task deliverable will be updated as part of the semi-annual reports to USAID.

Objective

During the next twelve months, the SEC plans to assist the SEBI in the following areas:

- I. Legal and Regulatory;
- II. Capacity for Regulatory Oversight and Inspection of self-regulatory organizations (SROs) (which include stock exchanges, clearing agencies and depositories) and market participants (which include broker-dealers, investment companies, investment advisors, registrars and transfer agents, and securities information processors);
- III. Capacity for Investigation and Enforcement of securities law violations; and
- IV. Disclosure and Reporting Standards, including accounting and auditing standards.

Tasks

Task 1: Strengthening the legal and regulatory framework.

Strengthening legal framework for investor protection. The SEC plans to conduct a comprehensive review of the securities law and regulations. This review will cover the legal and regulatory framework regarding disclosure and reporting standards; regulatory oversight of the securities market, SROs and market participants; and enforcement of securities law violations (including unlicensed activities, financial fraud, market manipulation, insider trading and violations of securities laws and regulations by SROs and market participants). The review and any recommendations will focus on how to improve investor protection in India.

The SEC plans to provide training to SEBI officials regarding the legal structure needed for capital market development. A significant portion of the Capital Market Training Program in India will be devoted to the proper legal structure needed for capital market development. The SEC's Annual International Institute for Securities Market Development also addresses such training.

Investor education and assistance. Although SEBI has a program in place, it appears fragmented. SEBI staff refers complaints to appropriate officers, but they do not follow up on all complaints. Although SEBI has prepared a detailed pamphlet for investors, the information is dense and difficult to understand. In a single document, SEBI has provided a glossary of key terms, a list of offices investors should contact with grievances, information about the risks, rights and responsibilities of owning securities, and a discussion of trading

and transfer of shares, depository functions, and dematerialization. Many of these points should be addressed separately.

The SEC will provide technical assistance to improve the investor education and assistance program at SEBI. The SEC plans to provide investor education training in its Capital Market Training Program in India. The SEC official providing the training also will be available for follow up conversations with SEBI officials regarding the establishment of a comprehensive program. The SEC's Annual International Institute for Securities Market Development also addresses such training.

Task 2: Assisting the SEBI to improve its capacity for regulatory oversight and inspections.

Regulatory oversight. Although SEBI operates under the SEBI Act and has issued approximately 18 regulations, it has not defined certain key terms and concepts in the regulation of Indian securities markets. These concepts include manipulation, insider dealing, misappropriation, fiduciary, suitability, and “best price prevailing.” SEBI officials have expressed concern that because Indian law is not well developed, they have relied on US law to determine whether they should prohibit particular conduct.

As part of its legal and regulatory review, the SEC will review the SEBI's regulatory oversight program. The review will assess the effectiveness of the SEBI's regulatory oversight program for the securities market, SROs and market participants and make recommendations to strengthen the SEBI's regulatory oversight authority. The SEC also plans to provide training to SEBI officials regarding the regulatory oversight of the securities market, SROs and market participants. The Capital Market Training Program in India will cover regulatory oversight issues. The SEC's Annual International Institute for Securities Market Development also addresses such training.

Capacity for rulemaking. SEBI's procedures generally include internal consultation only. Although SEBI has on occasion sought selective input from industry through committees, this input appears arbitrary. Market participants have expressed concern that committees call meetings on short notice and do not make available appropriate material in advance of meetings. Moreover, this process does not include input from all firms or other market participants who may wish to have a voice.

As part of its legal and regulatory review, the SEC will review the rulemaking process and recommendations to enhance transparency in the rulemaking process. The SEC also will provide training to SEBI officials regarding the rulemaking process in the U.S. The SEC's Annual International Institute for Securities Market Development also addresses such training. The

SEC also will include such training in its Capital Market Training Program in India.

Inspection of SROs and market participants. It is unclear whether India has a coordinated plan to conduct periodic inspections of SROs and market participants. The roles and duties of the various SROs in the inspection of market participants also are unclear.

The SEC plans to assess the SEBI's inspection procedures for SROs and market participants. As part of that review, the SEC will review how SROs and market participants are currently inspected and provide recommendations regarding the SEBI's inspection procedures, including how the SEBI determines to inspect an SRO or a market participant. The SEC also plans to work with the contractor and the U.S. private sector securities industry to develop a training program for senior officials of the SEBI and relevant SROs in India in charge of inspections. The program would cover areas such as the inspection of SROs and market participants, market surveillance, broker-dealer compliance programs and the SEC's oversight of SRO inspection and surveillance programs. The Annual International Institute for Securities Market Development and the General Capital Market Training Program in India also will conduct training in this area.

Task 3: Strengthening SEBI's capacity for investigations and enforcement actions.

Investigation and enforcement procedures. SEBI employs a complex multi-step process in bringing enforcement actions. Procedures include conducting a preliminary investigation, obtaining an order for a formal investigation issued by the Chairman, a report to the Chairman by SEBI staff, a decision to appoint an Inquiry Officer, a decision by the Inquiry Officer to issue a show-cause notice, a hearing before the Inquiry Officer, and a hearing before the Chairman, who makes a final determination as to sanctions.

The process, however, is not transparent. Certain key documents -- such as the final order issued by the Chairman -- are not publicly available. This causes uncertainty in the law with respect to conduct that SEBI believes violates the securities laws. Although SEBI often publishes a press release about an enforcement matter on its website, reasoning on why SEBI found a particular violation is generally skeletal.

The SEC plans to assess the SEBI's investigation and enforcement procedures. As part of that assessment, the SEC will assist SEBI in making its investigation and enforcement procedures more transparent and more open to the public. The SEC also will recommend procedures to inform the public about SEBI's decisions regarding specific enforcement cases.

Financial Institutions Reform and Expansion (FIRE) II – Work Plan

Enforcement training. The SEBI has expressed concern that many SEBI staff who conduct investigations have not had sufficient training in areas such as (i) identifying when to commence an investigation; (ii) determining what key documents to request; (iii) interpreting key documents, which might suggest a violation; (iv) identifying appropriate persons from whom to obtain statements; (v) determining appropriate lines of inquiry in taking statements; and (vi) determining what evidence to seek in follow-up to previous inquiries.

In respond to this need, the SEC plans to conduct a two to three day training program in India on conducting investigations and preparing enforcement actions. The SEC also will provide slots for three SEBI officials to attend the Annual Institute for Securities Enforcement in fall 2001. The Annual International Institute for Securities Market Development and the general Capital Market Training Program in India also will include training in the enforcement area.

Task 4: Improvement in disclosure and reporting standards.

Disclosure and reporting standards. As stated in the discussion under Tasks 1 and 2, the laws and regulations are not well developed, this includes the law and regulations regarding disclosure and reporting standards. As part of the SEC's review of the securities law and regulations in India, the SEC will review the disclosure and reporting standards and make recommendations to strengthen those standards.

Training of disclosure and reporting standards. The SEC includes a review of the U.S. disclosure and reporting standards in its Annual International Institute for Securities Market Development. The SEC also will include such training in its Capital Market Training Program in India. The SEC plans to work with the contractor and the U.S. private sector securities industry to conduct appropriate technical assistance and training in this area.

Planned Training and Technical Assistance Projects

- **Judicial Training Program**

Task: The SEC will conduct a judicial training program for members of the Securities Appeals Tribunal, the SEBI Chairman, full time members of SEBI and SEBI staff that act as Administrative Law Judges. The course will cover SEC's Administrative procedures, how administrative law judges conduct hearings, Commission review of administrative proceedings, enforcement's decision to prosecute and the choice of venue, the settlement process at the SEC. In addition, the course will include discussion with Judges from the Federal District Court about

Financial Institutions Reform and Expansion (FIRE) II – Work Plan

conducting a trial and sessions with NASD officials regarding its disciplinary process. The program would be conducted in Washington, DC for four days. This training will cover topics under Task 3.

Deliverable: A four-day course presented by the staff of the SEC and NASD and judges from the SEC and Federal DC District Court.

Counterpart: SEBI

Target Date: October/November 2005.

Status/Comments:

- **International Institute for Securities Enforcement and Market Oversight**

Task: This institute focuses on practical techniques for conducting investigations, market surveillance and inspections of broker-dealers, mutual funds and investment advisers. This training program will cover topics in Tasks 2 and 3.

Deliverable: A one-week program offered each fall at the SEC for regulatory officials from emerging and developed markets. The SEC plans to invite four senior regulators from the SEBI and one from each of the two major exchanges to the 2005 Enforcement Institute.

Counterpart: SEBI and the exchanges

Target Date: November 14-18, 2005

Status/Comments: Invitations for the program should be sent out in early September 2005.

- **Enforcement and Market Oversight Conference in India**

Task: The training program is designed to build on the report and recommendations regarding the SEBI's enforcement program. The program will focus on investigative techniques, enforcement proceedings and market oversight issues. This training program will cover topics in Tasks 2 and 3.

Deliverable: A 3 ½ day program in India for the staff of SEBI and the exchanges and a 1 ½ day program for senior staff of SEBI.

Counterpart: SEBI

Target Date: December 5-10, 2005

Status/Comments:

- **International Institute for Securities Market Development**

Task: This institute is designed for senior regulators and stock exchange officials and is intended to promote market development, capital formation, and the building of sound regulatory structures in emerging market countries. This training program will cover topics in each of the four tasks.

Deliverable: An intensive two-week program of lectures, panels and workshops held each spring at the SEC and an optional internship with various market entities the week following the institute. The SEC plans to invite four senior regulators from the SEBI and one delegate from each of the two stock exchanges from India to the 2006 Institute.

Counterpart: SEBI and stock exchanges

Target Date: Spring 2006

Status/Comments:

- **Broker-dealer Inspection/Training Program**

Task: The SEC (possibly with the help of the NASD) will conduct a training program on how to conduct inspections of broker-dealers followed by an inspection of a broker-dealer. This training program and the inspection will be conducted in the U.S. and is designed to teach officials of SEBI how to conduct broker-dealer examinations under task 2.

Deliverable: A one-week training program covering various aspects of a broker-dealer inspection and an inspection of a broker-dealer firm for one week.

Counterpart: SEBI

Target Date: Summer 2006.

Status/Comments:

- **Inspection of an Indian Investment Adviser Jointly Registered with the SEC and SEBI**

Task: An inspection team from the SEC will join an inspection team from the SEBI to conduct a joint inspection of Investment Adviser in India. The SEC will lead the inspection. The inspection is designed to show senior members of the SEBI Inspection Program how the SEC conducts an inspection of an Investment Adviser. This training program will cover topics in Task 2.

Deliverables: The SEC and SEBI will hold one or more videoconference regarding pre-inspection details including the production of a list of documents for the inspection. The SEC and SEBI inspectors will conduct a one-week inspection of an Investment Adviser in India. The SEC and the SEBI inspectors will hold post inspection conferences by videoconferencing. The SEC and the SEBI inspectors will produce a report of the inspection.

Counterpart: SEBI

Target Date: 2006.

Status/Comments:

- **Inspection of A Securities Exchange and Depository/Settlement Organization**

Task: An inspection team from the SEC will assist an inspection team from SEBI to inspect an exchange and the depository/settlement organization associated with that exchange. The SEC will provide guidance to SEBI staff in the conducting of the inspections. This training will cover topics in Task 2.

Deliverables: The SEC and SEBI will hold one or more videoconferences regarding the inspections and areas of the exchange and depository that will be included in the inspection.

Financial Institutions Reform and Expansion (FIRE) II – Work Plan

The SEC and SEBI inspection teams will conduct an inspection (that will last 5-7 business days) of the exchange and depository/settlement organization. After the inspection, the SEC staff will work with the SEBI inspection team to produce an inspection report. That help will be done in the United States and may involve conference calls and videoconferences.

Counterpart: SEBI and stock exchanges

Target Date: 2006

Status/Comments:

- **Capital Markets III**

Task: The SEC will conduct a training program open to securities regulators from the various countries in the region. The topics covered by the program will be determined after consultation with the SEBI. The staff of the SEC, SEBI and possibly the World Bank will conduct the training. This training program will cover topics in each of the four tasks.

Deliverable: A one-week training program in India for approximately 80 or more securities regulators and market professionals from India and other parts of Asia. Course instructors will comprise of staff from the SEC, SEBI and possibly the World Bank.

Counterpart: SEBI and SROs (exchanges, depositories, member associations). Representatives of other countries will also be invited to attend at their own expense

Target Date: 2006.

Status/Comments:

International Institute for Securities Enforcement and Market Oversight

Task: This institute focuses on practical techniques for conducting investigations, market surveillance and inspections of broker-dealers, mutual funds and investment advisers. This training program will cover topics in Tasks 2 and 3.

Financial Institutions Reform and Expansion (FIRE) II – Work Plan

Deliverable: A one-week program offered each fall at the SEC for regulatory officials from emerging and developed markets. The SEC plans to invite four senior regulators from the SEBI and one from each of the two major exchanges to the 2006 Enforcement Institute.

Counterpart: SEBI and the exchanges

Target Date: Fall 2006

Status/Comments: Invitations for the program should be sent out in September 2006.

The SEC will work with the contractor and the U.S. private sector securities industry to provide appropriate technical assistance and training opportunities. As these opportunities are identified, the SEC will provide any necessary amendments to this Work Program.