India's New Stock Exchange

The Future of Financial Sector Reforms

Paul Joseph
Principal Advisor, MCX-SX

www.mcx-sx.com

Financial Services

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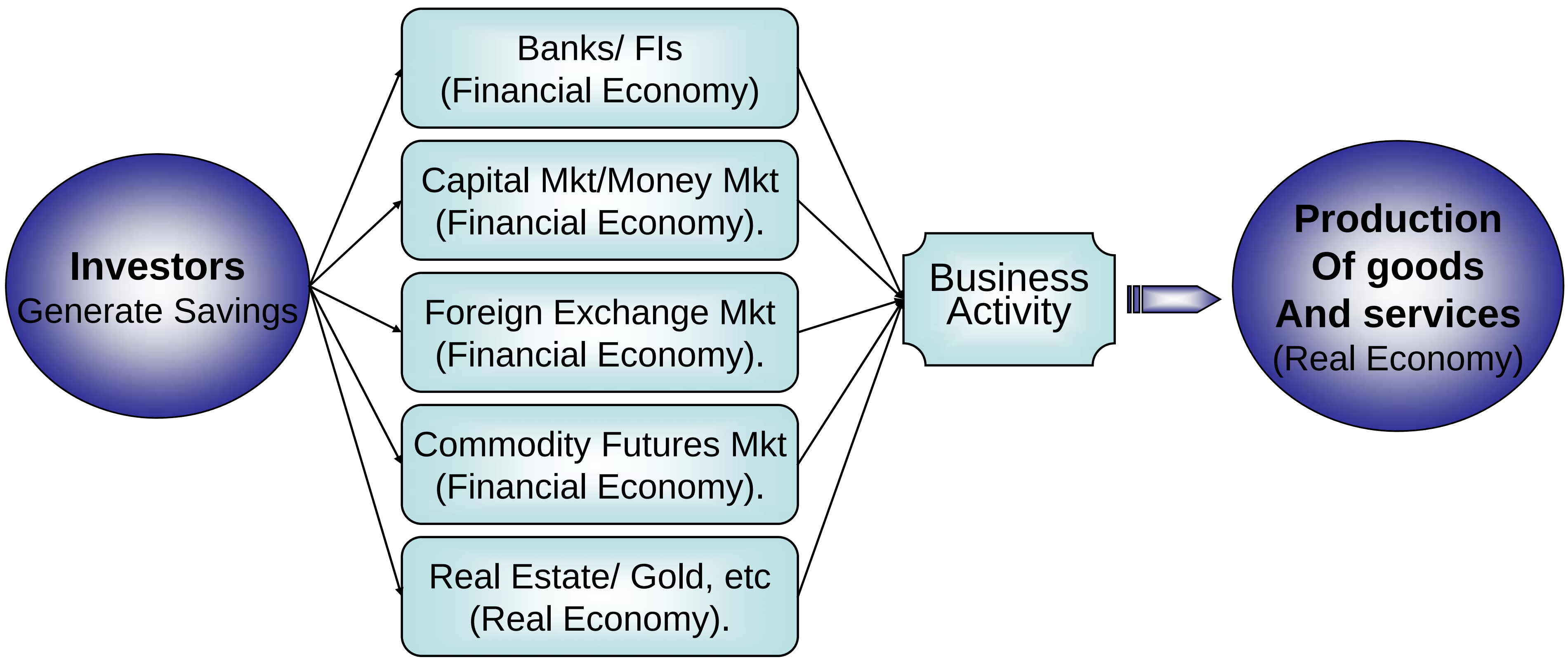
- A conduit for transfer of resources



Financial Sector Overview

Capital Market

Consist of Equity, Debt and Derivatives Market. Major players are Institutions High Net Worth & Retail investors

Forex Market

Consists of dealing in Foreign Currency & exchange transactions Major Players are Banks

Money Market

Consist of dealing in short & long Term debt securities issued by Both Govt. & business entities Major players are Banks & PD's

Loan Market

Consists of commercial & retail Loans to corporate and non-Corporate borrowers. Major Players: Banks/FI's & Finance Co's

Insurance/ PF Pension

Consists of selling insurance/ Retirement products & deploying Such funds in investments. Major players are LIC, GIC And other private insurance Co's

Savings and Investment Mkt

Consists of mobilization of retail Savings and providing investment Options. Major players are Govt. Small savings, banks, FI's & MF's

Importance of Financial Sector

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- Financial Sector provides —
  - products for mobilising household and corporate savings,
  - investment avenues in the securities market,
  - credit for producing and consuming goods and services and creating long term assets,
  - transaction banking for facilitating economic activity and insurance services for risk mitigation,
  - long-term savings and social security.

- A financial market is essential for creation and exchange of financial assets.

- Financial markets play key role in allocation of resources in an economy by performing the functions of (i) facilitating price discovery, (ii) providing liquidity to financial assets and (iii) reducing the cost of transacting.

Review of Policies- Historical Background

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- Financial issues have always been an important component of Public Policies in India as finance is critical for development.
- Financial sector policies in the early post-Independence period were aimed at building and promoting Financial Institutions. Emphasis was laid on expanding the geographical spread of the banking system and providing credit to priority sector activities.
- Nationalisation of Banks (in July, 1969) and Policies on banking helped in the spread of branch banking in rural and under-banked regions, better credit delivery for priority sector activities.
- Financial system in the pre-reform period, largely catered to the needs of planned development. Public sector had a dominant position in the Financial system reflecting the then existing ideology summed up in the phrase: “to occupy the commanding heights of the economy”.

Review of Financial Sector by Committees

Name of the Committee	Chairman	Year
Committee on the Financial System	M.M Narasimham	1992
Committee on Banking sector Reforms	M.M Narasimham	1998
Committee on Fuller Capital Account Convertibility	S.S Tarapore	2006
High Powered Expert Committee on Making Mumbai an International Financial Sector	Percy Mistry	2007
Committee on Financial Inclusion	Dr.C. Rangarajan	2008
High Level Committee on Financial Sector Reforms	Prof. Raghuram G. Rajan	2008
Committee on Financial Sector Assessment	Dr.Rakesh Mohan	2009

Catalysts and Results of Financial Sector Reforms

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Catalysts

- Economic Shocks
  - BOP Crisis of 1991
  - Ballooning of Fiscal Deficit

- New Govt. in the Centre with Dr. Manmohan Singh as FM

Results

Financial Sector Reforms

- Deregulated Interest Rates
- Opening Economy to Foreign Competition
- Reforms in Stock market- Securities and Exchange Board of India (SEBI) established on 20th Feb, 1992 for protecting the interests of investors and regulating the securities market.
- Control on capital issues abolished in May,1992.

Catalysts and Results of Financial Sector Reforms

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- A competitive environment created which have put pressure on public sector banks to clean up their Balance Sheets and consolidate their operations.

- New opportunities emerged in a big way in para-banking activities such as merchant banking, housing finance, Mutual Funds, insurance and project finance.

- In order to enhance competition, establishment of new banks in the private sector was allowed and foreign banks were also permitted more liberal entry.

- Besides, Foreign Direct Investment in private sector banks up to 74 percent was allowed.

Significant Results of Reforms

- Number of Bank branches in rural areas increased from 1443 (17.6% to total) in December, 1969 to 30,572 (44.5% to total) in March, 2006. Total number of Bank Branches including Regional Rural Banks increased from 8187 in December, 1969 to 68,681 in March, 2006.

- From a very insignificant level of credit to the agricultural sector during the years prior to Bank Nationalisation, the credit share of the sector moved to nearly 11% in the mid-1970s and to about 18% at the end of the 1980s.

- Share of agriculture in total bank credit stood at 10.8% by March, 2005. This may be seen against the relative decline in the share of agriculture in the country's GDP.

- The induction of technology has led to fast processing of transactions in banks. Transmission of funds to customers is faster now. ATMs provide easy access to cash to depositors.

- Prudential regulation and supervision of banks have improved.

Significant Results of Reforms

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- No-performing loans to total loans of commercial banks declined to 3.3 percent at end-March 2006 from the level of 15.7 per cent at end March, 1997.

- The extent of penetration of the banking system in India as measured by the proportion of bank assets to GDP has increased from 50 per cent in the second half of 1990's to over 80 percent a decade later.

- The share of the public sector banks in total banking assets has come down from 90 percent in 1991 to around 75 percent in 2006.

- Banking sector reforms have resulted in greater efficiency and productivity through increased competition.

Areas of Concern in Banking

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- Inspite of Policy and regulatory directives towards financial inclusion, 41 percent of the adult population in India is un-banked.

- According to the National Sample Survey Organization 59th Round (Jan-Dec 2003), 45.9 million farmer households in the country (51.4 %) out of a total of 89.3 million households did not have access to credit from institutional or non-institutional sources.

- There exists a significant urban-rural divide in the access to banking facilities and credit.

- Only 39 percent and 9.5 percent of the adult rural population have bank accounts and loan accounts, as compared with 61 percent and 14 percent respectively in urban areas.
- Financial services still not reaching majority of Indians on the retail side. (Raghuram G Rajan Committee)

Way Ahead for Banking Sector Reforms

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- Consolidation of banks may be encouraged to increase the size of the Balance Sheet and to provide better services, to reduce cost and to face global competition.

- Risk management covering all aspects of risk including credit risk, market risk and operational risk should receive more attention. New methodologies for assessing credit risk in lending to services and housing sectors and consumers need to be evolved.

- Flow of credit to agriculture, allied activities and micro, small and medium enterprises should be stepped up on a continous basis for achieving inclusive growth.

- Financial inclusion and larger flow of credit to rural population should receive higher priority.

- Larger Public shareholding needed in Public Sector Banks for better price discovery through Stock Exchanges and for improving Corporate Governance.

Securities Market Development – Regulatory Framework

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Reforms in Regulatory Framework		
Features	**1991**	**Post-reform period**
Regulator	Central Government oversight	A separate Regulator for Securities Market – SEBI.
Disclosure	Voluntary, vague and non-standardized	Standardized, systematic and a dedicated website for disclosures by listed companies.
Mode of Access	Public issues at fixed prices	Public issue at market determined prices, private placement, qualified institutional investors.
Pricing of Securities	Determined by Central Government.	Determined by market.

Securities Market Development – Changes in Market Structure

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Reforms in Market Structure		
Features	**1991**	**Post-reform period**
Structure of Stock Exchanges	Mutual, Not-for profit entities	Demutualised, for-profit corporate entities.
Form of Securities	Physical	Dematerialized
Derivatives Trading	Absent	A wide array of Exchange traded derivatives on Futures and Options.

Securities Market Development – Reforms in Market Operations

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Reforms in Market Operations		
Features	**1991**	**Post-reform period**
Trading Mechanism	Open Outcry	Screen based trading system
Settlement Cycle	14 day account period settlement	Rolling settlement on T+2 basis
Form of Settlement	Physical	Electronic
Risk Management	No focus on risk management	Comprehensive risk management system
Transfer of Securities	Cumbersome	Securities are freely transferable electronically.
Enforcement	Inadequate provision of penalty, time consuming investigation process.	Speedy disposal of investigation cases by enhancing the power of SEBI.

Achievements in the securities markets after reforms

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- India's equity market has developed substantially after the reform process initiated during 1991-92. BSE's market capitalisation exceeded US$ 1 trillion for the first time in 2007.
- Indian Stock Exchanges provide screen based trading on par with the most advanced Exchanges in the world.
- Rolling settlements in India are in T+2 mode, while most of the advanced Exchanges in the world including the US still have T+3 cycle.
- Over 90% of the securities issued by the companies are in Demat mode.

Achievements in the securities markets after reforms

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- Equity market has become an important source of funding for enterprises and a provider of investment opportunities for households.

- Stock market capitalization had increased significantly from about 40 % of GDP in 1994-95 to over 150 % in 2006-07.

- Obtaining finance from local equity market has become easy in India than almost anywhere in the world – India is ranked 3rd on the Pillar of Financial Market Sophistication, behind only Hong Kong and Qatar. (Global Competitiveness Index, 2009-10)

- Venture Capital is also becoming more prevalent, providing an additional growing channel for financing with India placed 23rd on the Pillar of Financial Market Sophistication. (Global Competitiveness Index, 2009-10)

Achievements in the securities markets after reforms

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- Currency Futures Trading commenced on 29th August, 2008 on NSE. It commenced on MCX Stock Exchange on October 7, 2008.

- Total value of currency futures contracts has increased from Rs.8.78 billion on 7th October, 2008 to Rs.189.65 billion on 4th Nov, 2009.

- RBI in its Second Quarter Review of Monetary Policy 2009-10 (Oct 27, 2009) has proposed to permit stock exchanges to offer futures contracts in currency pairs of Euro-INR, Japanese Yen-INR and Pound Sterling-INR, in addition to US dollar-Rupee contracts which are already permitted.

Achievements in the securities markets after reforms

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- In view of this development, SEBI has on 4-11-2009 sought suggestions from Stock Exchanges on various aspects of introducing additional currency futures contracts.

- Based on the Report of the RBI – SEBI Standing Technical Committee on Exchange Traded Interest Rate Futures, SEBI on 17th June, 2009 asked Stock Exchanges to apply to SEBI for offering Interest Rate Futures.

- At present, NSE is offering trading in Interest Rate Futures with effect from 31st Aug, 2009. MCX Stock Exchange will offer Interest Rate Futures in due course of time.

Challenges in the Securities Market

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- The participation of Indian households in the securities market is still low. According to SEBI-NCAER Survey of Indian Investors (2003), only 13.1 million, i.e 7.4 % of All India households representing 21 million individuals directly invested in equity shares or debentures or both during the financial year 2000-01. Objective should be to reach at least 100 million investors within next 10 years.

- Investment in shares and debentures as a percentage of household financial saving declined from 17.1 % during the period 1991-92 to 1995-96 to 8.5 % in 2007-08 according to various Reports brought out by the Reserve Bank of India. Objective should be channelise at least 25 % of financial savings into Stock Market.

- There is still a strong preference for Indian households to invest their savings in gold for various reasons. India is the world's largest consumer of gold, accounting for about 28% of annual global gold purchases during the year, 2007.

Challenges in the Securities Market

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- Top 100 companies in USA account for 54 % of the total trade in the stock market. In India, the trade concentration is as high as 90 %, which gives rise to the problem of thin trading for most of the listed scrips.
- Government and SEBI need to encourage greater competition in all areas of Securities Market infrastructure
- Greater competition among Stock Exchanges will lead to better services to investors, lower transaction costs, product innovation and greater financial inclusion.
- The corporate Bond market continues to remain practically non-existent inspite of several reforms announced by SEBI and Ministry of Finance following the Patil Committee Report.

Way Forward for Reforms in the words of PM

- The Prime Minister on the occasion of inauguration of India Economic Summit on 8th November, 2009 in New Delhi stated:
- "Though the global financial crisis did not affect Indian banks or our financial market directly, it drew attention to the need to strengthen our system in various ways. We need to ensure that the financial system can provide the finance needed for our development, and especially for infrastructure development. This opens up a broad agenda for reform.
- We need to develop long-term debt markets and to deepen corporate bond markets. This in turn calls for a strong insurance and pension sub-sectors. Some of the reforms needed, especially in insurance, involve legislative changes. We have taken initiatives in this area and will strive to build the political consensus needed for these legislative actions to be completed. We need to improve futures markets for better price discovery and regulation. We also need to remove institutional hurdles to facilitate better intermediation."

THANK YOU