

REGULATION OF FINANCIAL MARKETS AFTER TWO YEARS OF LEHMAN

A COMMENT

POLICIES FOR GROWTH AND FINANCIAL STABILITY BEYOND THE
CRISIS- THE SCOPE FOR GLOBAL COOPERATION

A JOINT ICRIER-InWEnt-DIE CONFERENCE
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“Recurrently over the centuries men have supposed that they have mastered the secret of its (money) infinite amplification.

And as reliably as they have persuaded themselves, they have also persuaded others”

John Kenneth Galbriath

Money: Whence it came, where it went

“Bubbles are far more dangerous when
they are fuelled by debt”

Carmen Reinhart and Kenneth Rogoff
This Time is Different
Eight Centuries of Financial Folly

“Over the years, government has had a great deal to do with Wall Street’s development, more than financiers would like to admit”

Charles R. Geist
Author
Wall Street, A History

1980s: LDC Debt Crisis

Bank lending gone bad

1990s: Crisis in Asia/Latam

Bank borrowing gone bad

2000s: Global financial crisis

Securitization gone bad

Debt has been a major factor in
accentuating the crisis every time.

Reports and Reviews

The de Larosiere Report

cross-border financial supervision

The Turner Review

capital requirements and accounting reforms

G20 proposals for financial reforms

Ensuring financial stability : FSB establishment

US Regulatory Reform

major overhaul of the US Financial System

Financial Services Oversight Council; Consumer Financial Protection Agency etc. Dodd-Frank Act, Volcker Rule

SIFI : *The new challenge*

The major challenge that emerged is how **systemically important financial institutions** (SIFIs) should be **regulated** and how failures, if they occur, should be **resolved**

Two interdependent dimensions of sources of risk identified.

Vertical or aggregate Dimension

Collective tendency to underestimate or overestimate risks.

Horizontal or Network Dimension

Interplay between institutions, markets and infrastructure which materializes in the form of common exposures.

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Policy Agenda

How to assess the systemic importance of a financial institution

Size ; Interconnectedness ; Substitutability

The rationale underlying a specific regulatory/supervisory treatment of SIFIs

Regulatory Objectives

increase the shock absorbing capacity of SIFIs and to lower their contribution to systemic risk, contagion and spillover effects.

mitigate moral hazard and the related implicit or explicit bailout guarantee with a clear focus on reducing the burden on tax payers.

Basel Committee Contribution

firm specific reform measures

Capital

Quality and level of capital base

Risk Coverage

Raising the level of capital
containing leverage

Liquidity

Global liquidity standards

Risk Management and Supervision

Market Discipline

Basel Committee Contribution

Macro Prudential Measures

Addressing Pro Cyclicality

capital buffers

Provisioning

Systemic risk and interconnectedness

Contingent capital

Cross-border bank resolution

Basel Committee Contribution

Implementation of reform measures

Impact Assessment

Comprehensive quantitative impact study

Macroeconomic impact assessment

Transition to the new standards

Basel Committee Contribution

Future Work

**Fundamental review of the trading
book**

ratings and securitizations

systemically important banks

contingent capital

large exposures

cross border bank resolutions

After the Crisis

Market rebound not accompanied by economic revival

Growth whatever happened not accompanied by job creation

Inflation emerged as a major worry

Competitive currency regimes that may pose danger of trade wars

After the Crisis

Budget balances come under strain in several countries

Global structural imbalances continue to persist

Sovereign debt problems linger on in crisis hit countries

Income inequalities becoming steeper across the developed and developing countries.

Concern that Continue....

Bank profitability restored but not the pace of loan growth

Coercive practices of banks in regard to foreclosures that might lead to protests

Growing unrest over cuts in public spending

Public pensions come under intense pressure

Financial Markets in Asia

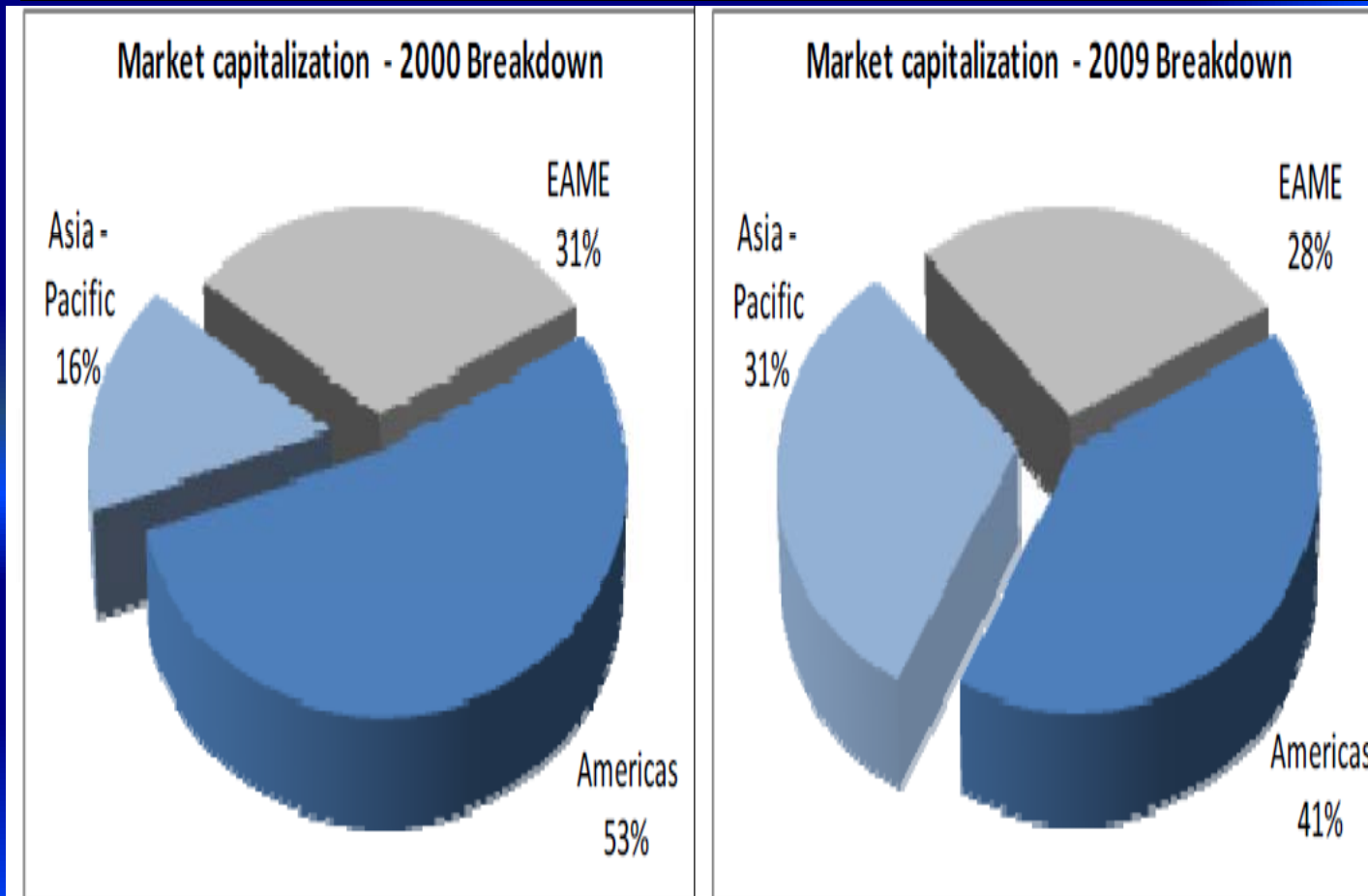
Financial markets growth is rapid and diverse in Asia

Gained significantly in terms of global market share in market capitalization and value of share trading

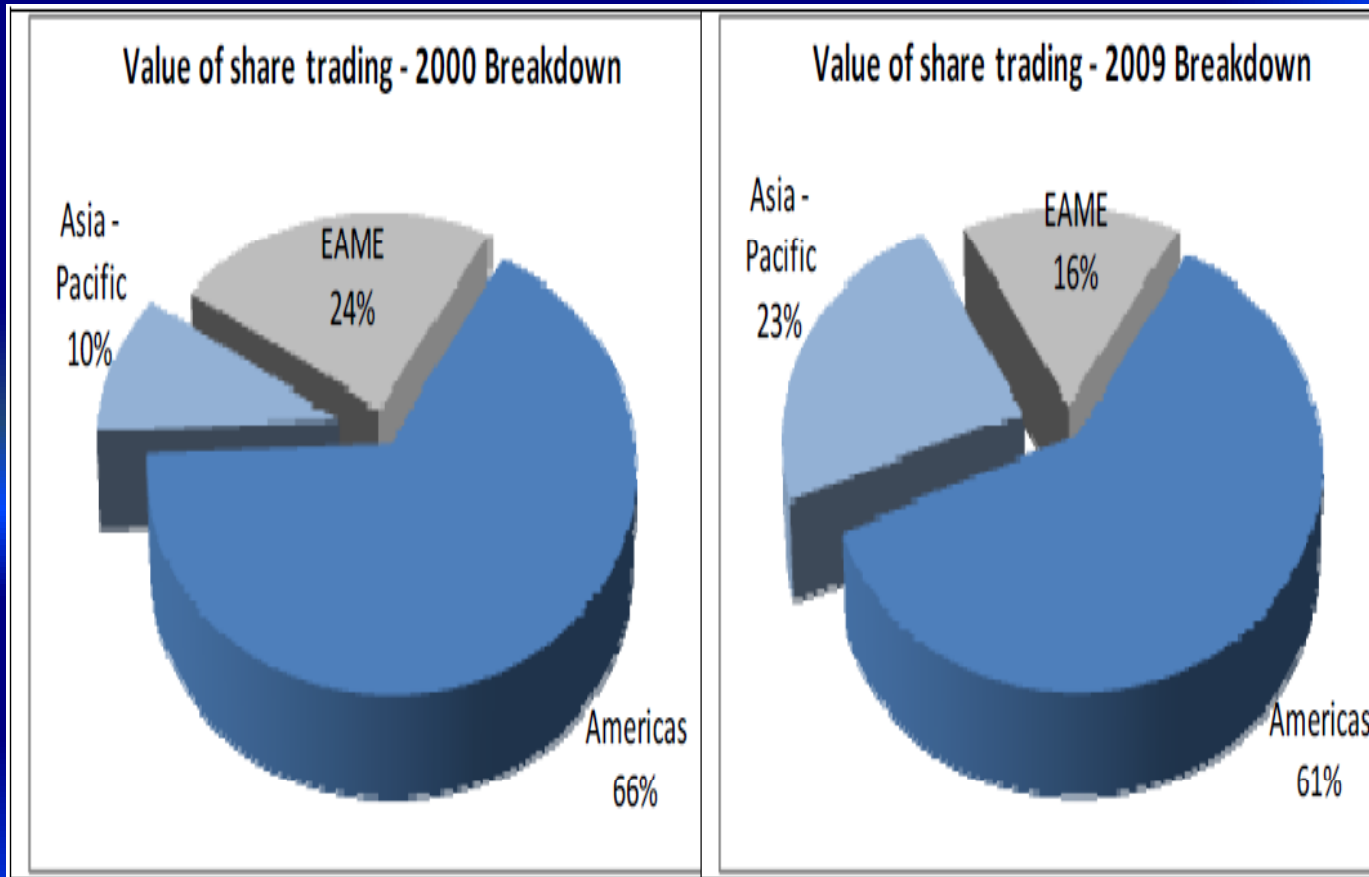
Asia emerged as a leading center for new capital issuance

Growth of multi asset classes growing participation of domestic and foreign institutional investors

Asia : Growing share in Market Cap



Asia : Growing Share in Trading Value



South Asia is also rapidly growing

Rapid growth in capital issuance

Diversified investor base

Large portfolio flows

Development of new market segments

Rapid growth of derivatives

Strong exchange industry

Mature market intermediation

South Asia : Domestic Bank Credit/GDP Ratio

%

Country	1990	2000	2007	2008
Bangladesh	22.41	34.18	58.28	59.38
India	51.43	53.02	64.20	71.59
Pakistan	50.87	41.60	45.92	-
Sri Lanka	37.98	43.75	45.02	42.84

South Asia : Market Capitalisation

US\$ bn

Country	1990	2000	2007	2008	2009	2010*
Bangladesh	0	1	9	12	21	..
India	39	148	1819	645	1227	1313
Pakistan	3	7	70	23	32	11
Sri Lanka	1	1	8	4	8	12

South Asia : Market Cap/GDP Ratio

%

Country	1990	2000	2007	2008	2009
Bangladesh	1.07	2.52	9.93	8.38	22.78
India	12.16	32.18	154.57	55.68	98.71
Pakistan	7.12	8.90	49.06	14.28	19.13
Sri Lanka	11.42	6.58	23.34	10.66	19.78

South Asia : Listed Companies

No.

Country	1990	2000	2007	2008	2009
Banglade	134	221	278	290	295
India	2435	5937	4887	4921	4955
Pakistan	487	762	654	653	650
Sri Lanka	175	239	235	234	231

South Asia : Main Stock Index Value

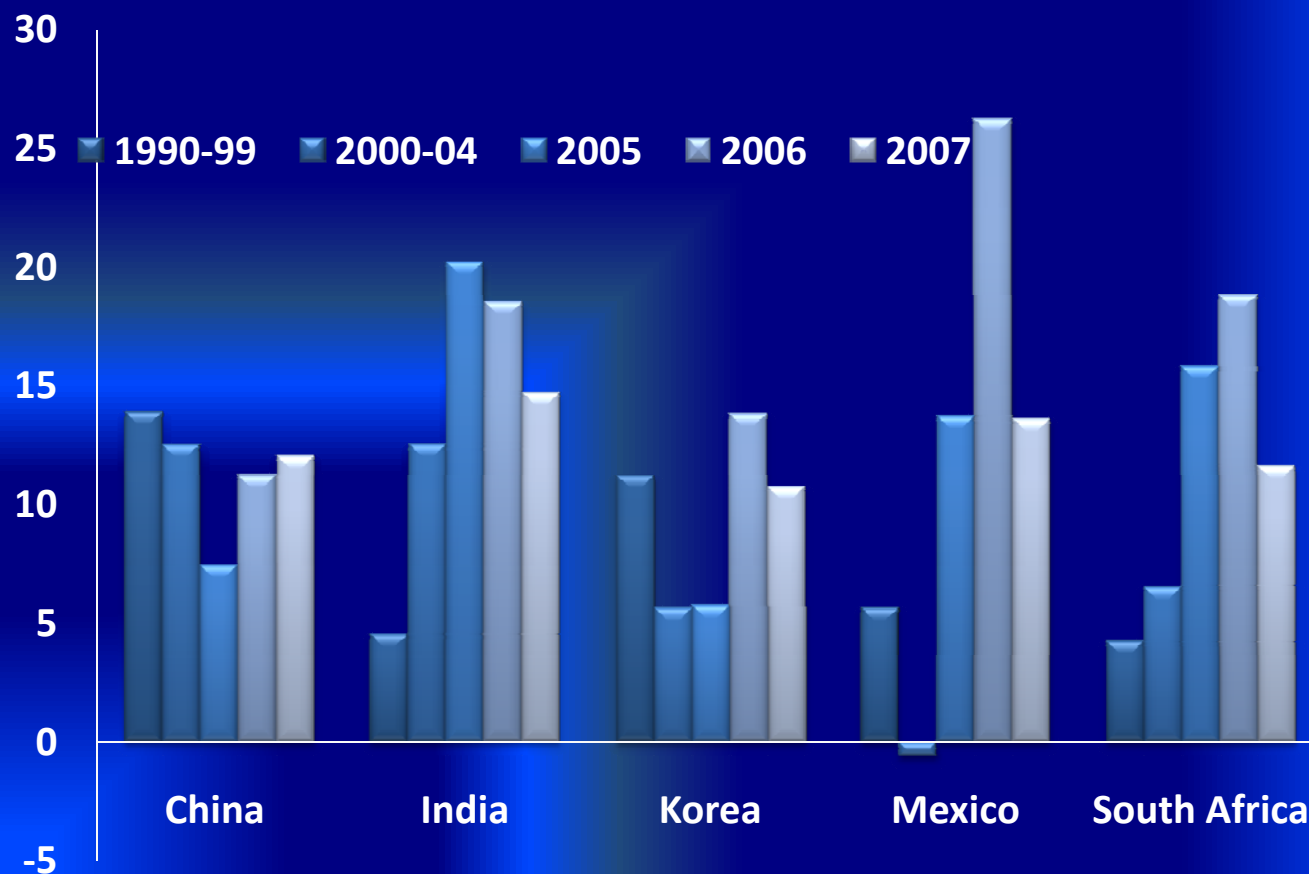
Country	1990	2000	2007	2008	2009	2010*
Bangladesh	351.1	649.9	3017	2795.3	4536	5363
India	1321	5610	20193	9569	17402	16931
Pakistan	591.3	1507	14077	5865	9387	10057
Sri Lanka	411.9	447.5	2796	2560.1	1579	3774

India Leads and has strength in
economic growth
financial markets development
scope and extent of financial sector
regulation
market development initiatives
indigenous expertise and
entrepreneurship
technology and process management
delivery and distribution

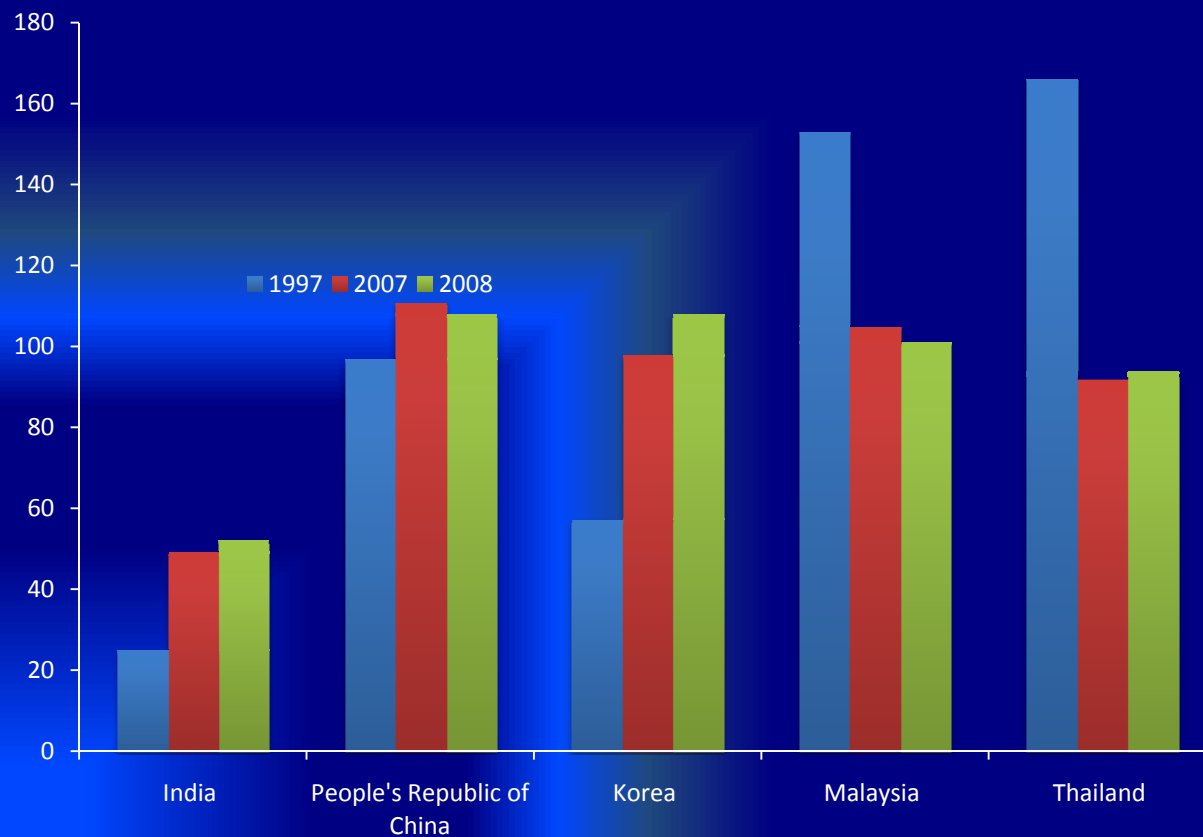
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India : Growth of Domestic Credit to the Private Sector

%

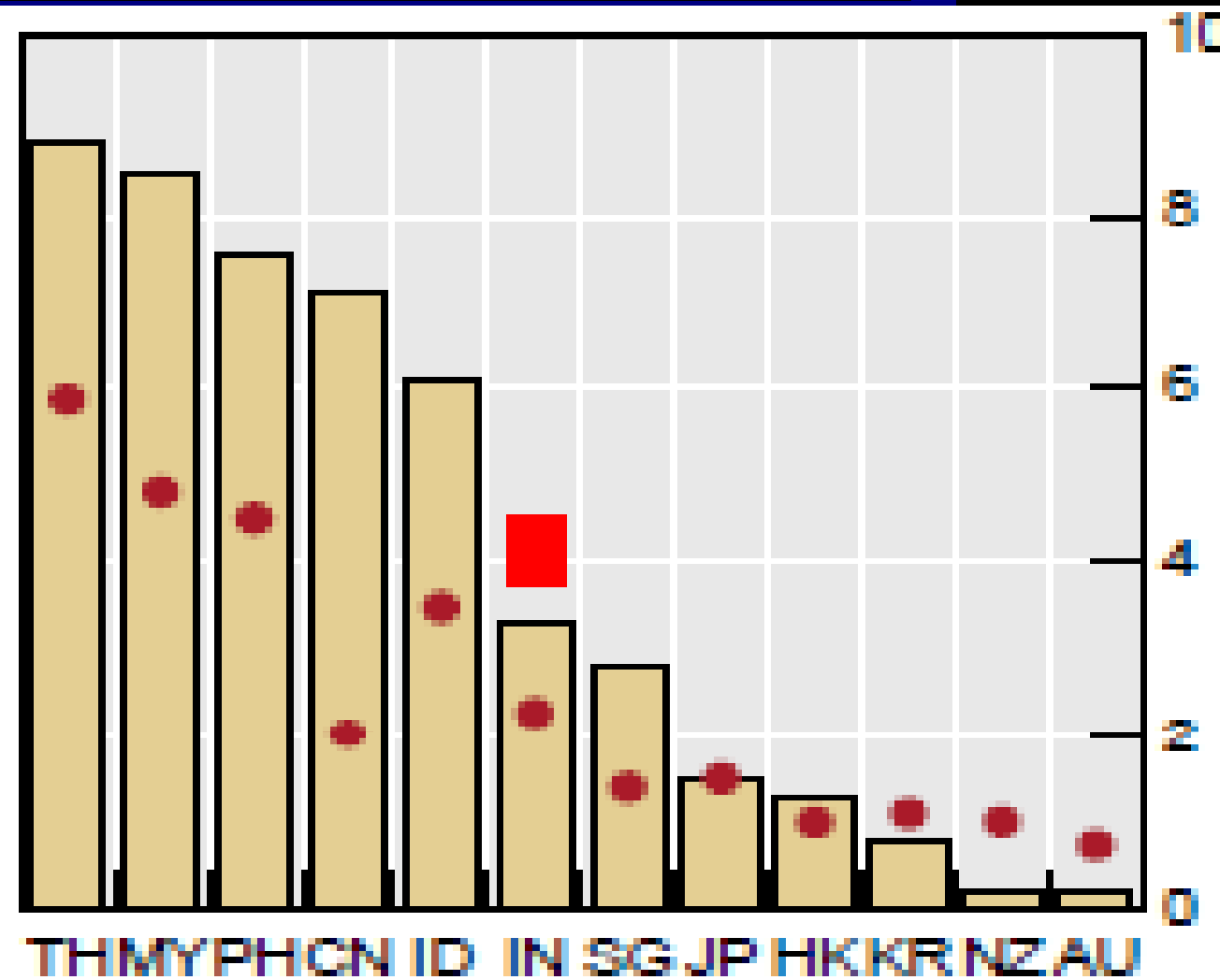


India : Role of Banks in Intermediation : Credit/GDP %



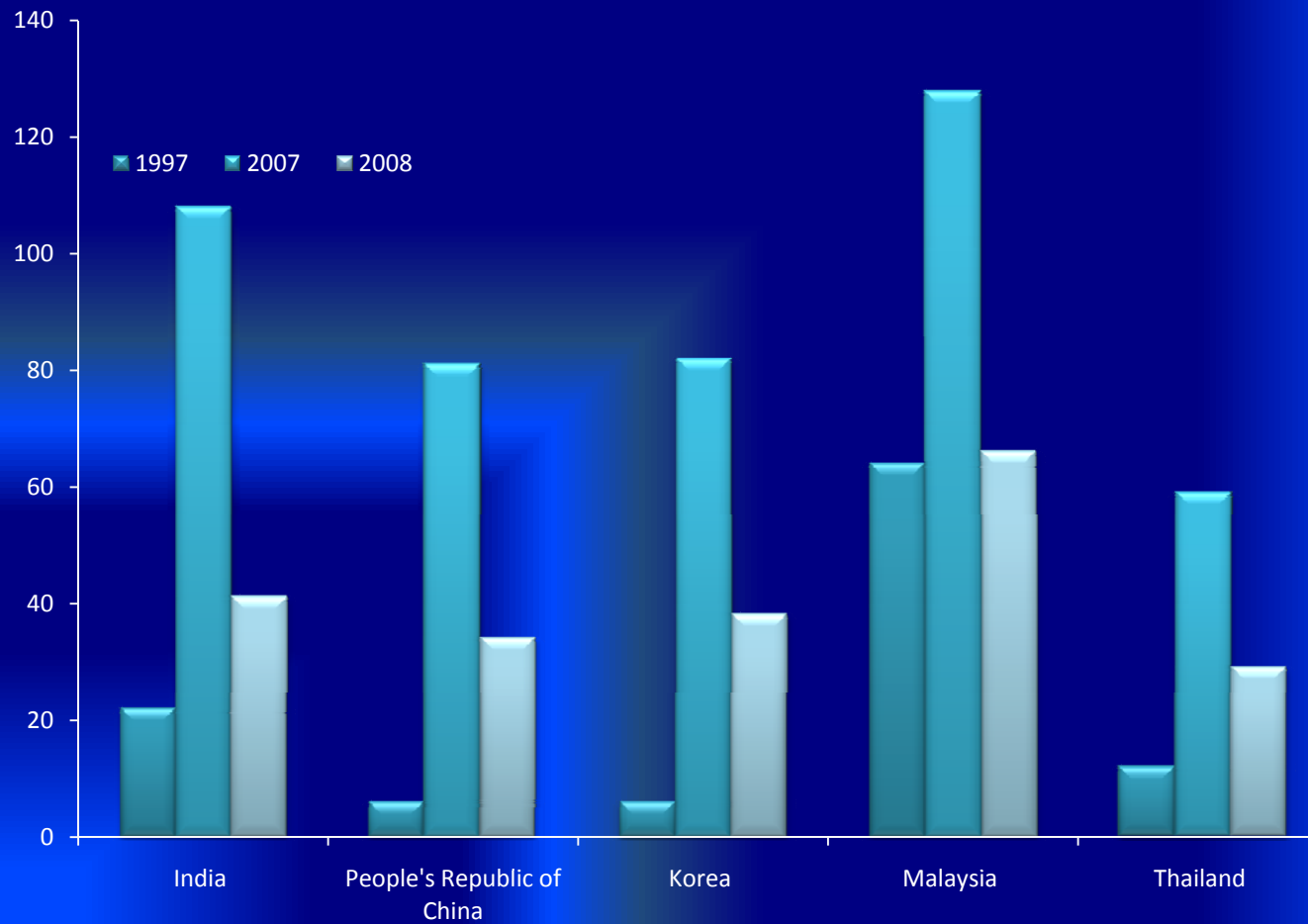
Asia : NPLs

%



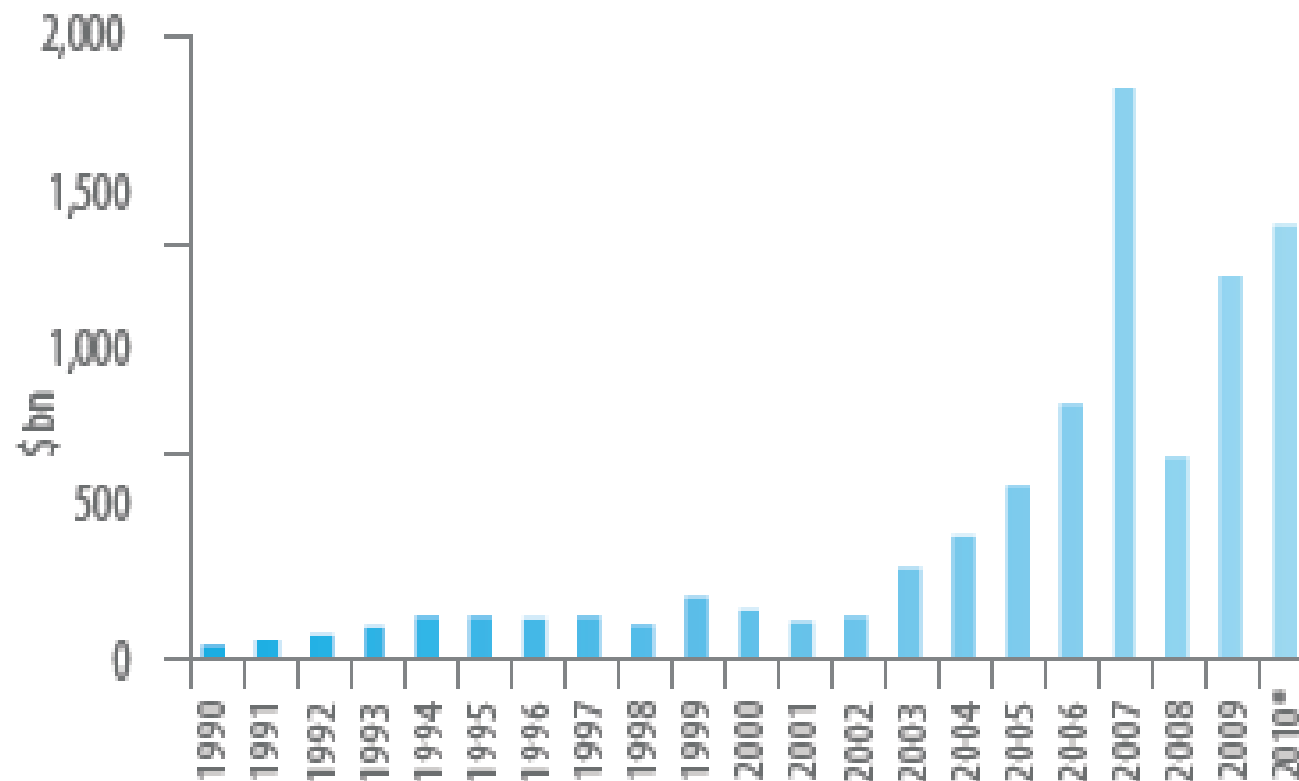
KNOWLEDGE for MARKETS
A Financial Technologies Group Initiative

India : Stock Market Cap/GDP %



India : Growth of Market Cap US\$bn

Market Capitalisation, 1990-2010



India : Strong Secondary Market

Average Daily Turnover (2009-10)	(\$ bn)
Equity Cash Segment	4.84
Equity Derivative Segment	15.5
Currency Derivatives	3.32
Commodity Derivatives	4.97
Fixed Income	2.77

Source :SEBI and Exchanges

India : Robust Market Infrastructure

Registered Market Intermediaries as on 31 March, 2009

National Stock Exchanges	3
Regional Stock Exchanges	23
Brokers	10239
Foreign institutional Investors	1635
Custodians	16
Depositories	2
Merchant Bankers	134
Underwriters	19
Credit Rating Agencies	5
Venture Capital Funds	132
Portfolio Managers	232
Mutual Funds	44

Source : SEBI

Banking Indicators as on 31 March, 2009

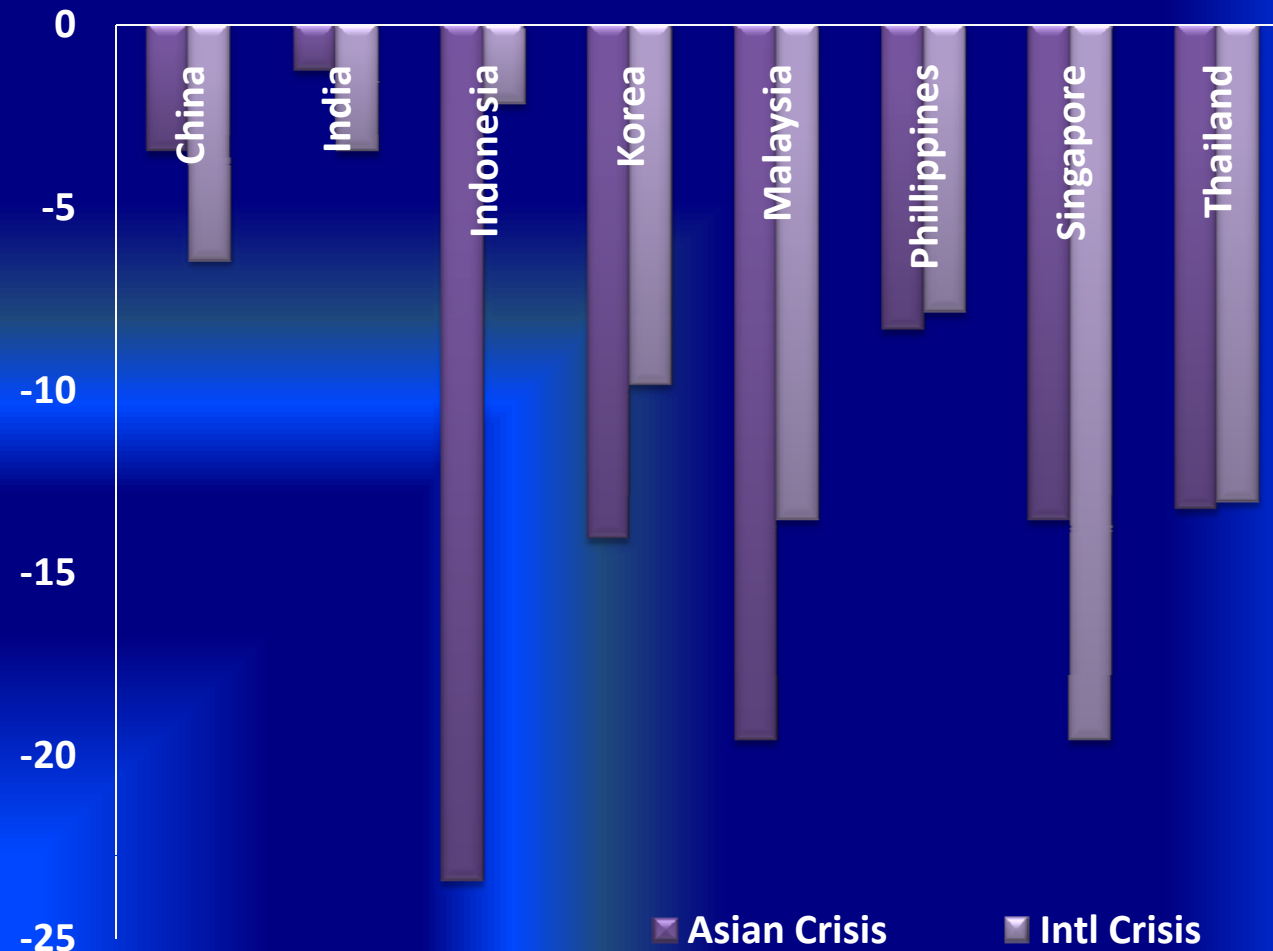
Regulator	Reserve Bank of India
Public Sector Banks	27
Private Sector Banks	22
Foreign Banks	31
Regional Rural Bank	86
Bank Branches	65181
Bank Deposit (\$ BN)	864.50
Bank Advances (\$ BN)	638.48
Source : RBI	

India weathered the crisis well

the impact of the crisis was fairly less in India as compared to others in key areas

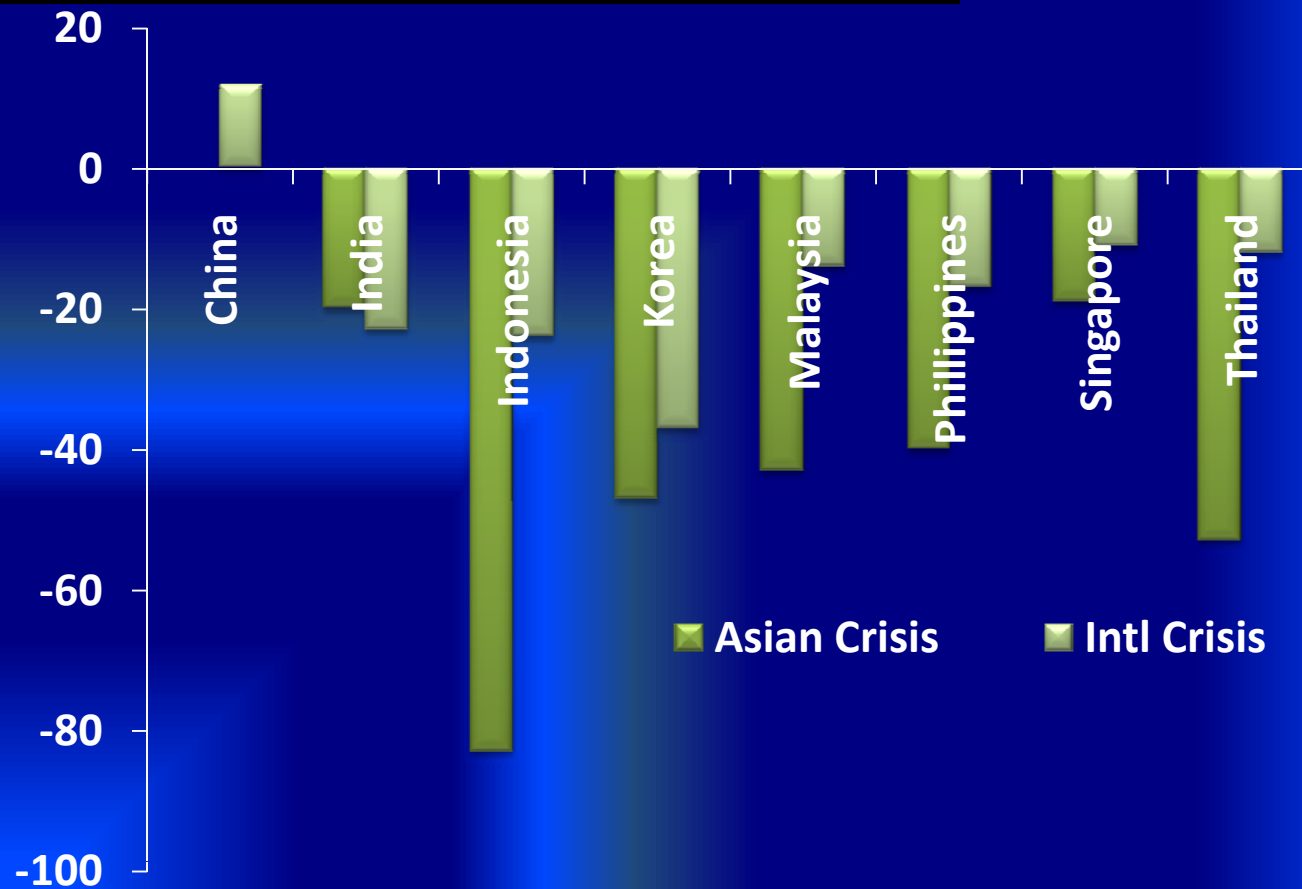
Strong internal factors along with good macro and monetary management reduced the incidence and impact of the fall out

Crisis Impact on GDP Growth

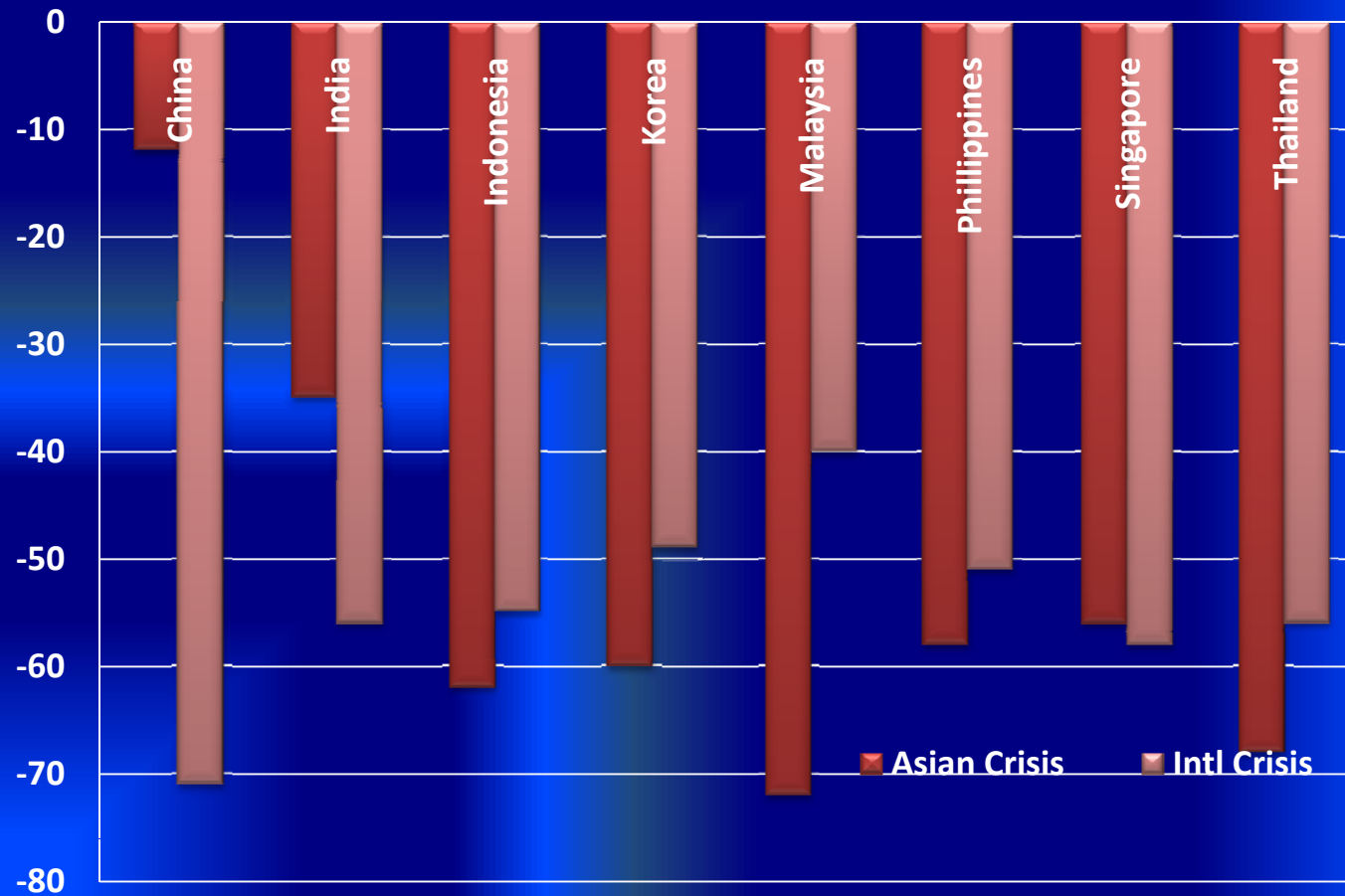


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Crisis Impact on Exchange Rates

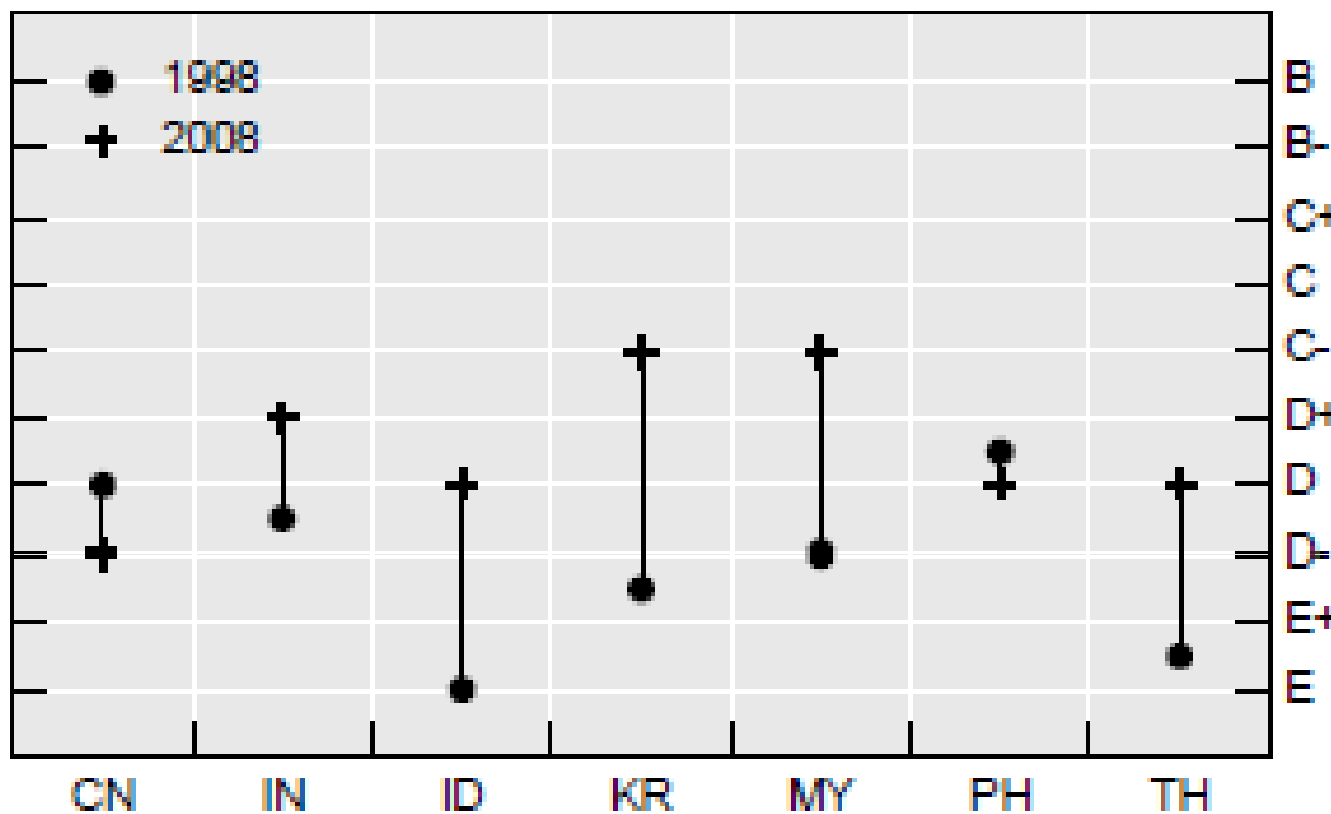


Crisis Impact on Stock Prices



Moody's Bank Financial Strength Rating

Asia



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Looking Ahead

South Asia led by India shows great prospect for financial sector development

Its recent experience could be of useful reference to emerging markets

India could play a proactive role in Asian financial sector growth and stability

scope for further progress in regulatory reform and transparency

promote cooperation in regional financial markets : Scope to Strengthen SAFE

Some Questions:

QE : How far and deep

Leading the global coordination :

Assuming challenging roles and responsibilities

Role of the State in Finance

Where do the poor fit in priorities

Watch and Vigil are important

Despite Asia's success, some of its vulnerabilities and weaknesses as evidenced from the experience in the past should not be overlooked.

Banking Crises in East and South Asia (1980-2002)

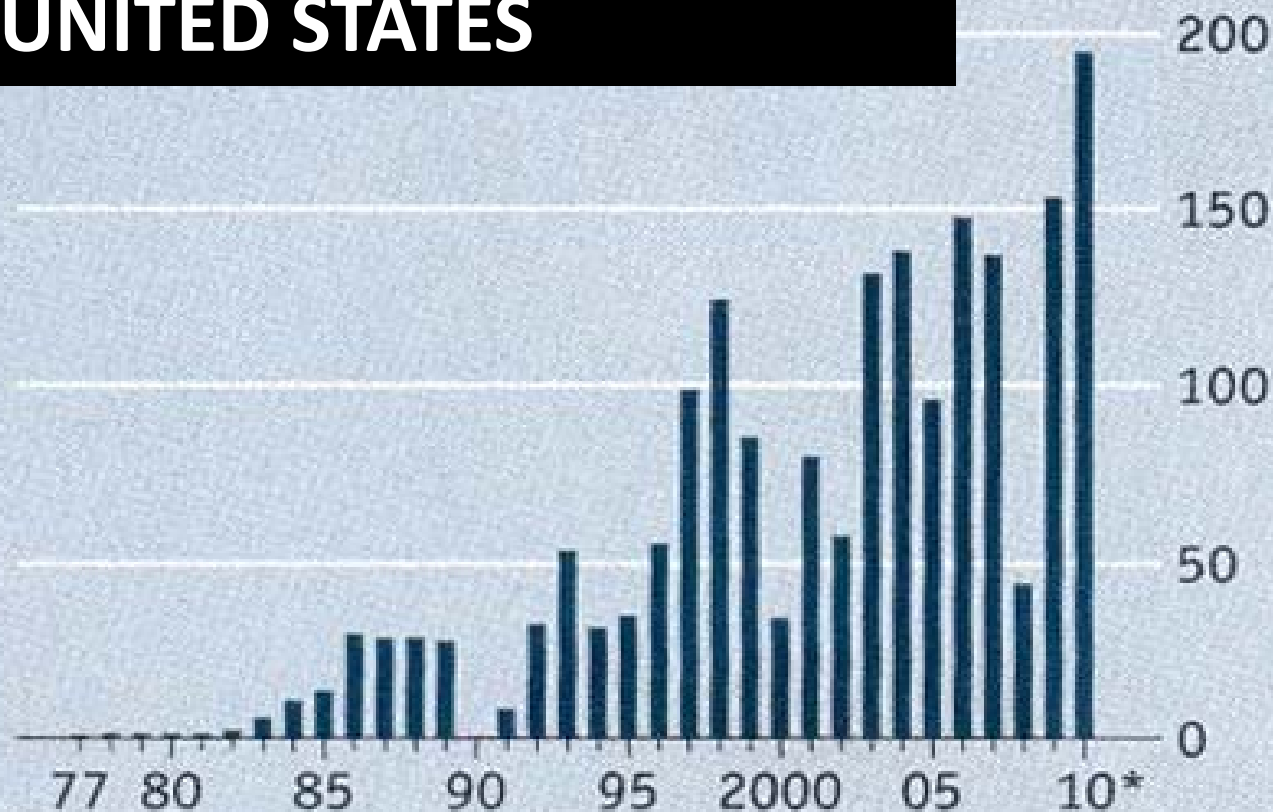
Country/Economy	Time-Frame	Non-performing Loans(% of total loans)	Fiscal Cost of Crisis (% of annual GDP)	Forgone Output (% of annual GDP)
Bangladesh	1985-1996	20		
China	1990-	50	47	
Indonesia	1997-2002	70	55	39
Japan	1991-	35	24	48
Korea	1997-2002	35	28	17
Malaysia	1997-2001	30	16	33
Nepal	1988	29		2.2
Philippines	1983-1987	19	3	26
Philippines	1998-	20	13	10
Sri Lanka	1989-1993	35	5	1
Taiwan	1997-1998	26	12	
Thailand	1983-1987		1	0
Thailand	1997-2002	33	35	40
Vietnam	1997-	18		23
Average for Asia(14 episodes)	1980-2002	32	22	22
average for rest of world (97 episodes)	1980-2002	41	15	12

A point to ponder

**will the structured products that have
been the cause of the problem regain
their prominence ?**

JUNK BOND GROSS ISSUANCE IN THE UNITED STATES

US\$ bn



Source: JPMorgan

* Year to date