

Mumbai – An International Financial Centre

- Report of the High-powered Expert Committee is timely and comprehensive.
 - Report is about 250 pages and since time is short, focus will be on its broader policy recommendations. Not on specific proposals e.g. eliminate securities transaction tax.
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Advantages

- ❑ Efforts to set up an IFC will promote more efficient allocation of capital.
 - ❑ To whatever extent it is achieved, it will enhance fees generated and retained.
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Advantages (contd.)

- ❑ Does India want to be a developed country? Can Mumbai be an IFC without India achieving a developed country status?
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- ❑ Mumbai as an IFC is an idea whose time has come.
 - ❑ However, as the report has pointed out, there are many pre-requisites.
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Competition

- ❑ Single most important issue in the Report is the need to enhance competition in the Indian financial sector.
 - ❑ This is particularly true in the Banking sector.
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Competition (contd.)

- Unlikely that there will be consensus in decision making circles in Government and Parliament for privatisation to proceed at the pace suggested in the table on page 209-210 of the Report, which is by 2011.
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Competition (contd.)

- ❑ A practical way to progress would be to promote entry of domestic private sector banks including allowing entry to corporates with appropriate regulatory controls.
 - ❑ Also allow unrestricted entry to global legal and accounting-auditing firms.
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INR Yield Curve

- ☐ INR yield curve is not adequately market determined and is not arbitrage free.
 - ☐ What is an arbitrage-free yield curve?
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INR Yield Curve (contd.)

- ❑ Substantial amounts of Central & State Government debt are issued at administered interest rates. This needs to be phased out. Over what time period?
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Deficits

- ❑ In the context of State and Central Government deficits, annual budgets should be presented on both cash and accrual based accounting basis (the latter including all contingent liabilities).
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Bond & Exchange traded derivatives markets

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- ❑ The Report has correctly identified these as missing markets which need to be developed.
 - ❑ Pre-requisite is an arbitrage-free market determined INR yield curve which in turn depends on reduction of State and Central Government deficits to manageable levels. We have to reach consensus on what are acceptable levels (flow and stock).
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Interest rate and FX derivatives

- OTC and Exchange traded
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Public Debt Management

- ❑ Reserve Bank of India is acting as the Central Government's merchant banker by issuing Government debt.
 - ❑ This should be phased out and as the Report recommends, a separate public debt management office needs to be set up.
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Public Debt Management (contd.)

- ❑ Such a PDO would issue sovereign debt and “manage” INR and foreign currency fixed income obligations.
(term structure and innovations)
 - ❑ Trading of sovereign and corporate bonds on a fully dematerialised basis on stock exchanges (NSE & BSE)
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BPO and KPO

- Even as we move towards a full-fledged IFC, specific attention needs to be paid to promote Mumbai as a Business Process Outsourcing (BPO) and Knowledge Process Outsourcing (KPO) center. Back-office and Middle-office. Front-office can follow.
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Training

- The Report's recommendation on training is timely and plans have to be drawn up how best to provide incentives for such training institutes to come up.

(The existing number of quality institutions is not adequate).

- Pricing of derivatives, complex structures, Actuarial training, etc.
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Legal Jurisdiction

- ❑ The legal jurisdiction (e.g. UK law) in case of disputes is specified in financial contracts. Given the protracted delays in the Indian legal system, this could be a major impediment and IFSAT may not be an adequately effective solution.
 - ❑ For instance, would an IFSAT ruling be subject to review by the Supreme Court.
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Capital Account Convertibility

- ❑ The suggested timeline in the Report for CAC appears to be unrealistic since this has to be linked to improvement in Government finances.
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Capital Account Convertibility (contd.)

- ❑ For an IFC, it may not be enough for the INR to be fully convertible on the capital account.
 - ❑ The INR probably has to be an international reserve currency. And, with a Government bond market that is deep and liquid at long maturities which provides AAA instruments for hedging purposes.
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Illustration

- A lead manager bank for a large bond issue will invariably short sell AAA-rated Government securities to hedge risk related to insufficient investor interest.
(Example in the Report of a South Africa railway project to be funded by issuing INR bonds out of Mumbai)
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Transactions and other fees

- ❑ The Report's estimates appear to be optimistic since the location where transactions are conducted does not have to coincide with the place where profits are booked.
 - ❑ IFIs will usually seek lowest tax and compliance regimes to book profits.
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Tax Regime

- ❑ Indian taxes are now comparable with many other jurisdictions. However, there are frequent legal challenges to existing rules/ regulations. This is likely to hamper the development of long-maturity financial contracts such as currency or interest rate SWAPS.
 - ❑ GST stamp duties etc. Need to rationalised. Telgi Scam
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Financial Sector Reforms

- ❑ Development of IFC has been made conditional to sweeping reforms of the regulatory structure in financial sector. Some of the suggested changes are desirable (e.g. principles based rather than rule based) but are these achievable in the time frame indicated?
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Financial Sector Regulatory Regime

- ❑ Comprehensive legislation e.g. Financial Services Modernisation Act. OK in principle, but this should be accompanied by repeal of all overlapping laws.
 - ❑ There are “turf” issues.
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Governance

- ❑ Many of the Report's sweeping recommendations refer to the need to improve governance.
 - ❑ These go much beyond the financial sector.
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Governance (contd.)

- ❑ For example, the recommendations on urban infrastructure.
 - ❑ Does the Report make the “best the enemy of the good”?
(Recommendations 39-48)
 - ❑ High growth rates on a sustained basis.
(Recommendations 1-3)
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Financial Inclusion

- ☐ Not included at all. Not even for all residents of Mumbai.
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Insurance and Pension sectors

- ❑ Let us not underestimate the power of technical solutions.
- ❑ There is much that can be improved upon even as we work towards consensus on ownership, reduction in deficits, governance, legal issues.

Thank you
