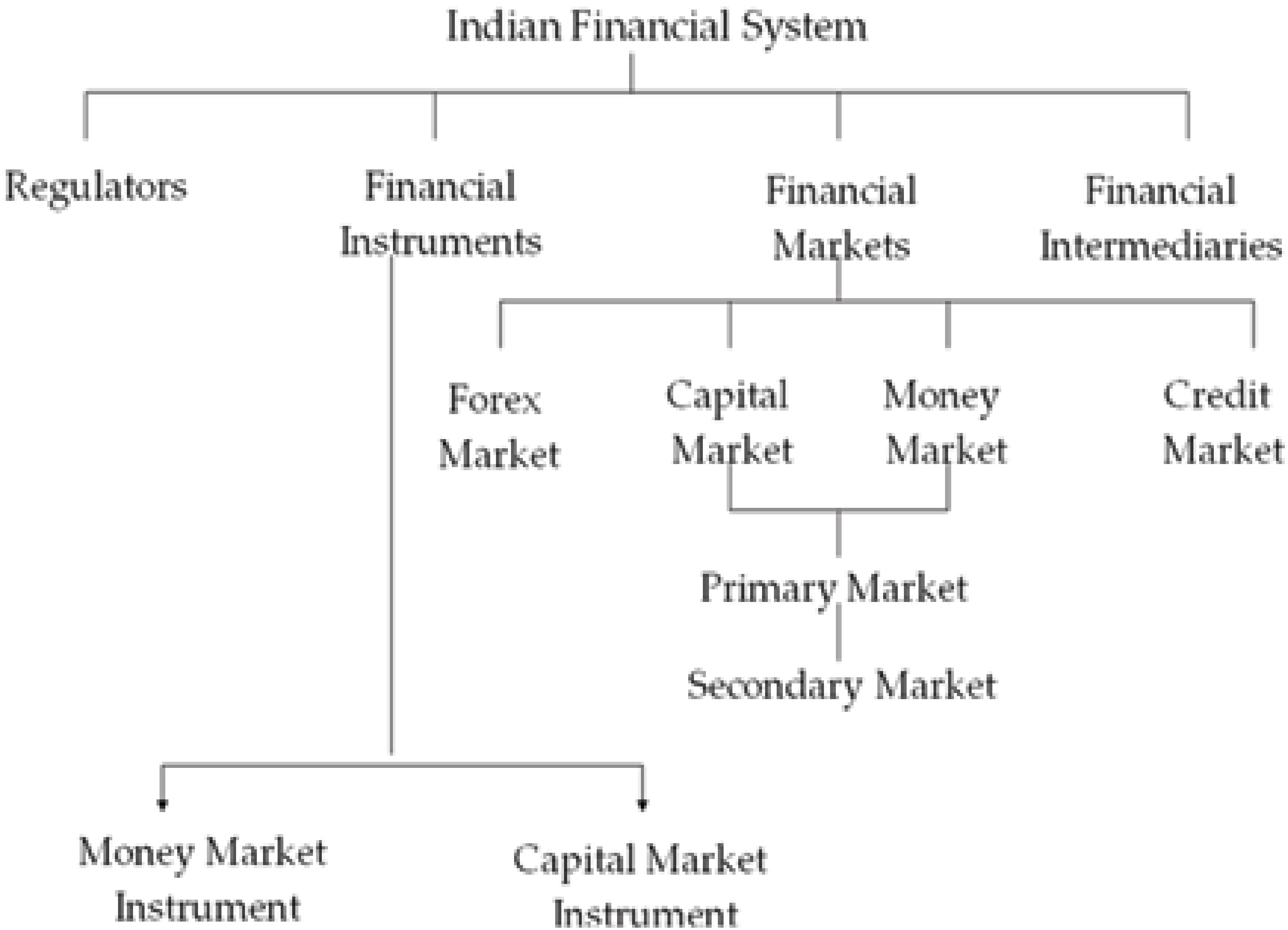
Financial Framework in India

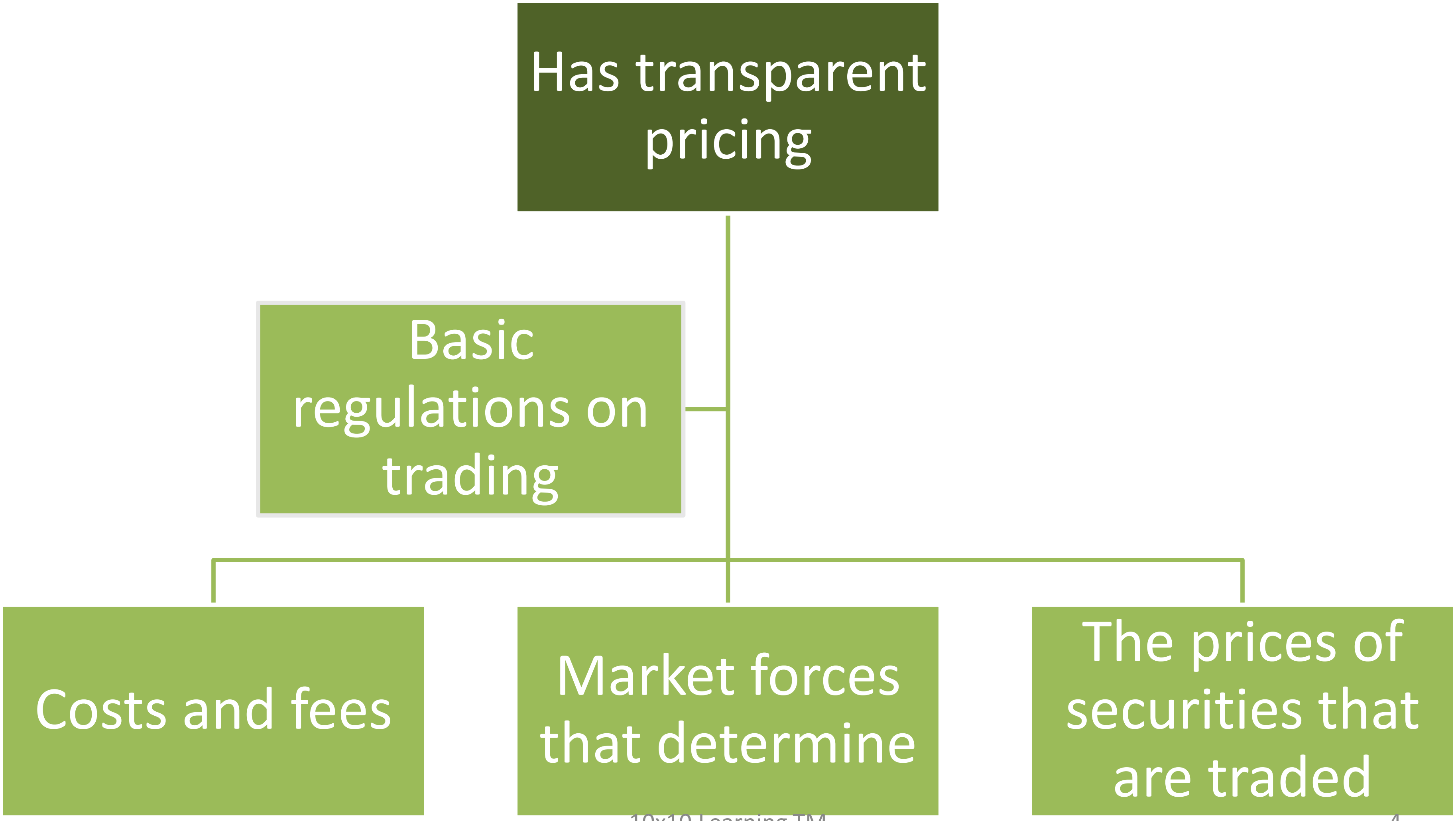
For Finance related courses and CSE Main Optional Paper on Finance


Indian Financial System
Regulators
Financial Instruments
Financial Markets
Financial Intermediaries
Forex Market
Capital Market
Money Market
Credit Market
Primary Market
Secondary Market
Money Market Instrument
Capital Market Instrument

Laws applicable to the Financial Sector : Act = 15. Rules = 10. Regulations = 40. Orders = 2 . Guidelines = 9. The 3 Acts at 4,5,15 are for securities market.

1) Negotiable Instruments Act, 1881
2) Reserve Bank of India Act, 1934
3) Banking Regulation Act, 1949
4) Securities Contracts (Regulation) Act, 1956
5) The Securities and Exchange Board of India Act, 1992 (SEBI Act) Replaced the Controller of Capital Issues
6) Recovery of Debts Due to Banks and Financial Institutions Act, 1993
7) Depositories Act, 1996
8) Foreign Exchange Management Act, 1999
9) The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) provides three methods for recovery of NPAs Securitisation, Asset Reconstruction, Exemption from registration of security receipt
10) Prevention of Money- Laundering Act, 2002
11) Credit Information Companies (Regulation) Act, 2005
12) Government Securities Act, 2006
13) Payment and Settlement Systems Act, 2007
14) Foreign Contribution (Regulation) Act (FCRA), 2010
15) Companies Act, 2013 : replaces the 1956 Act. Has 470 clauses in place of 700 sections, key changes for transparency in investments, promoting gender equality on company boards.

What is a Financial Market? A location to permit business and government to raise where buyers and sellers come into contact to exchange goods and services



Financial markets

Facilitate

1. The raising of capital (in the capital markets)
2. The transfer of risk (in the derivatives markets)
3. Price discovery
4. Global transactions with integration of financial markets
5. The transfer of liquidity (in the money markets)
6. International trade (in the currency markets)

Functions :

1. Borrowing and Lending
2. Price Determination : prices for new and existing financial assets
3. Information Aggregation and Coordination of value and flow of funds
4. Risk Sharing
5. Liquidity
6. Efficiency:

Types of Financial Market 1. Capital Market : Primary and Secondary

Basically for Manufacture, Services and Business sectors

For long term funds

1.Stock markets: Issue and trading of Shares. Securities Market .

2. Bond markets: Issue and trading of Bonds issued by Governments / PSUs and Debentures issued by private corporate entities.

3. Commodity markets : Trading commodities
4. Money markets : Short term debt financing

5. Derivatives markets : instruments for management of financial risk, transfer of risks

6 . Futures market

7. Insurance market

8. Foreign exchange market

The Capital market is a market for financial investments that are direct or indirect claims to capital. It is wider than Securities Market and includes all forms lending and borrowing, some of which may not include creation of a negotiable financial instrument.

Division of Capital Market

1. Gilt edged government securities RBI backed. No risk and highly liquid

2. Securities market for corporate securities and debentures.

Bankers to Issue are 47 . Under writers are 47
An Investment Bank assists the initial sale of newly issued securities (IPOs) by engaging a number of different activities like advice, underwriting , sales assistance. It is a financial intermediary. Merchant Banks are 148.

Primary Market Issuing houses, investment bankers, brokers are the channels .

Main service functions of primary market are original issue (IPO), under writing , distribution. Lead managers, brokers assist in these .

Secondary market: is the Stock Exchange assisting, regulating and controlling the business of buying, selling and dealing in securities

2. Money Market for Short term debt financing . Transactions through telephone and electronic systems . Is more secure than Capital market

Debt Market Instruments

1. Treasure Bills (T- bills)
2. State Development loans (SDL)
3. PSU bonds
4. Zero coupon bonds (ZCB)
5. Index bonds
6. Commercial Papers (CP) 1990
7. Certificates of deposits (CDs)
8. Corporate Debentures,
9. Strategy Linked Reconstruction bonds and non-SLR bonds issued by Financial Institutions.
10 Bonds Issued by Foreign Institutions
11. Units of Mutual Funds (MFs)

1. Wholesale Debt market is for a range of fixed income securities including government securities

Debt Market: deals in contracts for lending money, on pre-determined period and rate of interest.

Instruments are called Bonds, when issued by Governments Centralor States, PSUs .

Debentures when issued by private corporate sector.

Money Market Instruments

T Bills

- Treasure Bills (T- bills) of GoI : 3 types of T bills , 91 days, 182 days, 364 days. Min. Rs.25,000 and multiples. Issued at discount and redeemed at par. Also issued under Market Stabilization Schemes (MSS)
- Derivative has no independent value as its value is derived from its base or underlying asset. It is a forward , or a future, option or a hybrid contract of pre determined

Repurchase Agreements

- Also called Repo Rates or Reverse Repo : 2 parties agree to buy back the same security, usually for overnight borrowing.
- Can be done only between RBI approved parties and in RBI approved securities .Namely in GoI and State Government Securities , T- Bills, PSU Bonds, Financial Instruments Bonds, Corporate Bonds.

Commercial Papers and Certificate of Deposit

- Commercial Papers (CP) since 1990 listed company with > 5 crore. CP issued in multiples of Rs 25 lakh for minimum amount of Rs. 1 crore. 7 days to 1 year. (Can this concept be extended to provide up to one month liquidity to small farmers funding for one harvest season?)
- Certificate of Deposit (CD) is a negotiable money market instrument] issued against deposits in a bank account. Minimum Rs 1 lakh and multiples of 1 lakh from 7 days to 1 year.
- Financial Institutions can issue CD from 1 year to 3 years.

Commercial Papers, Futures Contracts, Derivatives

Banker's Acceptance a short term investment plan of a company

Commercial Bill of a Bill of Exchange for 3 months. Purchased and discounted by banks rediscounted by FIs

Forward market is over the counter informal financial market, for entering contracts for future delivery. It is used to control and hedge risks.

No cash or commodity actually changes hands in a forward price. In contrast, in a spot price commodity is exchanged.

Futures Contracts are standardized forward contracts, that are traded on a futures exchange. Are used for trading a range of instruments : currencies, interest rates, securities and commodities. Forward Contract Regulations Act, 1952. Forward Markets Contracts (Regulation) Rules , 1954 . Forward Markets Commission .

explore for rural area versions

Derivatives on Commodity Market are futures contracts, Swaps, Exchange traded commodities, forward contracts . National Agriculture Policy , July 2000 for trading in Futures . Sugar from May 2001, and all commodities from 01.04.2013. In a forward transaction, no

Commodity Market in primary products Agricultural / Minerals

Base can be an underlying asset, index, or reference rate , in a contractual manner.

The underlying asset can be equity, forex, commodity or any other asset.

1. Soft commodities are agricultural: wheat coffee, sugar
2. Hard commodities are raw minerals : gold, rubber, oil

5. Derivative is a product whose value is derived from the value of one or more basic variables, called bases

3. About 50 commodities are on the market world wide. Purely financial transactions have been increasing and outnumber physical trades.

4. Derivatives : Spot prices, forwards, futures and options on futures . Forward Contracts are secured by physical assets

Mutual Funds are investment companies

1. Mutual Funds invest in other companies or other instruments by using investors’ money.
2. Structure wise : Open ended MF is freely traded. Closed ended has a fixed period and fixed units, after which it is freely traded. Interval funds combine the two.
3. Investment Objective:

a) steady income by investing in debt instruments,

b) capital appreciation by investing in equities,

c) or both by making an equal allocation of the corpus in debt and equity instruments

Financial Intermediaries

1. Industrial Credit and Investment Corporation of India
2. Industrial Finance Corporation of India
3. Industrial Development Bank of India
4. Life Insurance Corporation of India
5. Unit Trust of India
6. Life Insurance Corporationof India

Stock Exchanges (Cash Market) = 22, SE (Derivative Market = 2. Credit Rating Agencies= 4 . Venture Capital Funds = 89 . Foreign VC = 71; Mutual Funds 40 . FII = 975, Custodians = 11

Investment Banks

- Bankers to Issue are 47 . Under writers are 47 An Investment Bank assists the initial sale of newly issued securities by engaging a number of different activities like advice, underwriting , sales assistance. It is a financial intermediary.
- Merchant Banks are 148.
- The 36-currency Real Effective Exchange Rate (REER)

Regulators SEBI, RBI, D/o Company Affairs

- Stock Exchanges are for the Capital market trade in shares and bonds of companies NSE, BSE and regional exchanges
- Clearing and Settlement organisations
- Brokerages
- Depositories= 2 National Securities Depository Limited (NSDL) and Central Securities Depository Limited. (CSDL)
- IFCI, ICICI, IDBI, UTI are called Development Financial Institutions (DFIs) . Their aim at supplying long term capital to the private sector. aim at supplying long term capital to the private sector.

Special institutions

- Asset Management Companies are for NPAs of Banks.
- Strategic Debt Restructuring Scheme (SDR) In this the creditors could take over the firm and re sell it to a new owner. 12 firms opened negotiation, only 2 concluded.
- Sustainable Structuring of Stressed Assets (S4A) : creditors could provide firms with debt reductions up to 50% to restore their financial viability. (Only 1 small case resolved)
- 50 companies accounting for 71 percent of the debt
- 'Public Sector Asset Rehabilitation Agency' (PARA),charged with working out the largest and most complex cases

National and Commodity Specific Exchanges in India

1. Multi Commodity Exchange (MCX), Mumbai
2. National Commodity and Derivatives Exchange (NCDEX), Mumbai;
3. National Multi Commodities Exchange, (NMCE), Ahmadabad
4. ACE Derivatives and Commodity Exchange, Mumbai
5. Indian Commodity Exchange Ltd., Mumbai
6. Universal Commodity Exchange Ltd., Navi Mumbai

1. Bikaner Commodity Exchange Ltd, Bikaner
2. Bombay Commodity Exchange Ltd, Mumbai
3. Central India Commercial Exchange Ltd, Gwalior
4. Cotton Association of India, Mumbai
5. The Chamber of Commerce, Hapur
6. First Commodity Exchange of India Ltd, Kochi
7. India Pepper & Spice Trade Association, Kochi
8. National Board of Trade, Indore
9. Rajkot Commodity Exchange Ltd., Rajkot
10. Spices & Oilseeds Exchange Ltd, Sangli
11. Surendranagar Cotton Oil & Oilseeds Association Ltd, Surendranagar
12. The Rajdhani Oil & Oilseeds Exchange Ltd, Delhi
13. Vijai Beopar Chamber Ltd., Muzaffarnagar

Reform areas : 4Rs Reform, Recognise, Restructure, Resolve

- Unclaimed accounts of Rs 40 million in EPFO
- Only 45% of contribution received by Employee State Insurance is paid as benefit
- Employees receive below Rs 20,000 pm receive only 55 % of their salary as 45% is currently deducted. They need to be given a choice

Knowledge and conceptual clarity regarding operation of financial instruments.
All instruments have a high degree of volatility

1. Equities

High risk ,
high returns

1. Stock Market
only through
stock exchanges

2. Bonds and
Debentures

Derivatives are instruments of risk management. Risk reduced by locking in asset prices, as per value of base index in a contractual manner. Can be for equity, forex , commodity etc

3. Derivatives
Forwards, Futures
Options since
2000-01

4. FX for
foreign
currencies
since 2008

Regulations ensure
That all markets have
Appropriate Risk
management systems.
Also for transparecy
Fairness, level playing
field

MCX for
commodities
since 2003

The Financial Sector Legislative Reforms Commission (FSLRC), Justice B.N. Srikrishna, in March 2011.

1. There are over 60 Acts and multiple rules and Regulations.
2. Merge into a new unified agency:

a) Securities and Exchange Board of India (SEBI)
b) Forward Markets Commission (FMC)
c) Insurance Regulatory and Development Authority (IRDA)
d) Pension Fund Regulatory and Development Authority (PFRDA)

3. Securities Appellate Tribunal be subsumed into Financial Sector Appellate Tribunal (FSAT).
4. Financial Sector Development Council (FSDC) be given statutory framework.
5. Setting up of a new Debt Management Office (DMO)
6. Sub suming the existing Deposit Insurance and Credit Guarantee Corporation of India (DICGC) into the Resolution Corporation.

7 agency financial regulatory framework

RBI with modified functions

Merge SEBI, FMC, IRDA, PFRDA

Securities Appellate Tribunal merged with FSAT

Deposit Insurance and Credit Guarantee Corporation of India merge with Resolution Corporation

A new Financial Redress Agency to be created

Debt Management Office to be created

FSDC to be given a statutory framework and modified functions

Other recommendations of FSLRC

1. The repeal or large scale amendment of all special legislations that

   a) establish statutory financial institutions

   b) lay down specific provisions to govern any aspect of the operation or functioning of public sector financial institutions.

2. The undertakings of all statutory institutions should be transferred to ordinary companies under Companies Act
3. their regulatory treatment should be identical as that applicable to all other financial companies
4. The Draft Indian Financial Code 2013 the FSLRC : 15 Parts, 450 clauses, 87 chapters, 6 schedules.