School of Management Studies

MMPF-006
Management of Financial Services

Expert Committee

Content

BLOCK 1
INDIAN FINANCIAL SYSTEM

UNIT 1 INDIAN FINANCIAL SYSTEM AND MARKETS: AN OVERVIEW

Objectives

After studying this unit, you should be able to:

- understand the meaning of the terms 'Financial System', 'Financial Markets' and 'Financial Institutions'
- appreciate the relationship between Financial System and Financial Markets;
- understand various instruments of Financial Markets and familiarise yourself with Global Financial Markets.
- appreciate the role of various participants in Money Market and Capital Market

Structure

1.1 FINANCIAL SYSTEM

The economic development of a nation is reflected by the progress of the various economic units, broadly classified into corporate sector, government and household sector. There are areas or people with surplus funds and there are those with a deficit. A financial system or financial sector functions as an intermediary and facilitates the flow of funds from the areas of surplus to the areas of deficit. The word 'system' in the term 'Financial System' implies a set of complex and closely connected or intermixed instructions, agents, practices, markets, transactions, claims and liabilities in the economy. Finance is the study of money, its nature, creation, behaviour, regulations and administration. Therefore, Financial System includes all those activities dealing in finance, organised into a system. The financial system consists of financial institutions, financial markets, financial instruments and the services provided by the financial institutions.

Financial System, Markets and Services

The Financial Institutions act as a mediator between the investor and the borrower. The investor's savings are mobilised either directly or indirectly via the Financial Markets by using various financial instruments and in the process utilizing the services of various financial services providers. The best example of a Financial Institution is Bank. People with surplus amounts of money make savings in their accounts and people in dire need of money take loans. The bank acts as an intermediate between the two.

Let us understand the features of the Indian Financial system:

- It plays an important role in the economic development of the country because it encourages both savings and investment
- The expansion of financial institutions and markets is facilitated by the system
- The financial system is a means in mobilizing and also allocating savings
- It plays a very important role is capital formation in the economy.
- It acts as a link between those who want to save and allocate to those who need money for their business needs.
- In short it acts as a channel for provision of funds to the needy.

Figure 1.1 gives a bird's-eye view of the financial system of an economy. As stated earlier, the financial system comprises of four major components.

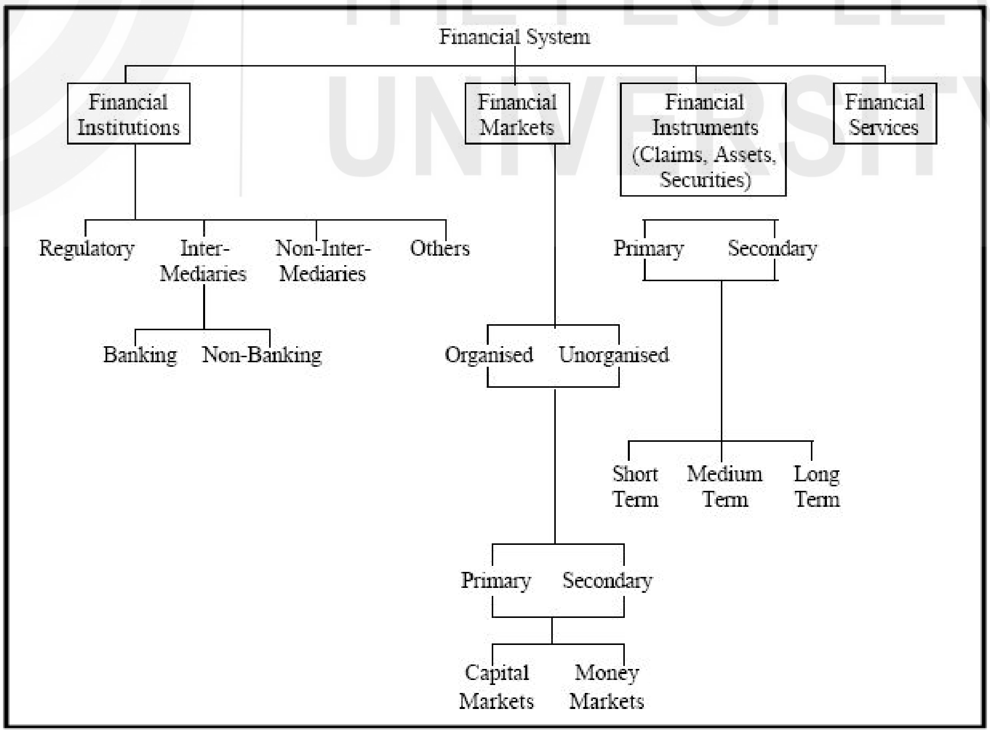

Figure: 1.1 : Financial System-Various Parts and Types of Classification

Source: Bhole, L.M., Financial Institutions and Markets: Structure, Growth and Innovations, TataMcGraw-Hill Publishing Company Ltd., New Delhi.

These components are:

1) Financial Institutions
2) Financial Markets
3) Financial Instruments
4) Financial Services

Before we go on to the main topic of this course, i.e. Financial Services, let us, briefly, know about the four components of the financial system.

1) **Financial Institutions:** Financial institutions are the participants in a financial market. These institutions collect resources by accepting deposits from individuals and institutions and lend them to trade, industry and others. They accept deposits, grant loans and invest in securities. As can be seen from Figure 1.1 these institutions can be classified into, Regulatory, Intermediaries, Non-intermediaries, and Others. These institutions unlike commercial organisations deal with only financial assets like; deposits, securities, loans, etc. On the basis of the nature of activities, financial institutions may be classified as: (a) Regulatory and promotional institutions, (b) Banking institutions, and (c) Non-banking institutions. A detailed discussion on these participant institutions is given in the subsequent paragraphs

2) **Financial Markets:** Financial markets are another part or component of financial system. This is a place or mechanism where funds or savings are transferred from surplus units to deficit units. Financial market deals in financial securities (or financial instruments) and financial services. These markets can be broadly classified into money markets and capital markets. Money market deals with short-term claims or financial assets (less than a year) whereas capital markets deal with those financial assets which have maturity period of more than a year This classification is artificial as both these markets perform the same function of transferring surplus funds to needy units. Another classification could be primary markets and secondary' markets. Primary markets deal in new issue of securities whereas secondary markets deal with securities which are already issued and available in the market. Primary markets by issuing new securities mobilise the savings directly. Secondary markets provide liquidity to the securities and thereby indirectly help in mobilising the savings. The participants in the financial markets are corporations, financial institutions, individuals and the government. These participants trade in financial products in these markets. They trade either directly or through brokers and dealers. A detailed discussion on the financial markets is available in subsequent sections of this unit itself.

3) **Financial Instruments:** Financial instruments are the financial assets, securities and claims. As already stated, the commodities that are traded

or dealt in a financial market are financial assets or securities or financial instruments. Financial assets represent claims for the payment of a sum of money sometime in the future (repayment of principal) and/or a periodic payment in the form of interest or dividend. Financial liabilities are the counterparts of financial assets. There is a variety of securities in the financial markets as the requirements of lenders and borrowers are varied. Broadly speaking the financial instruments can be classified as tradable and non tradable. For example financial assets like deposits with banks, companies and post offices, insurance policies, NSCs, provident funds and pension funds are not tradable. Securities (included in financial assets) like equity shares and debentures, or government securities and bonds are tradable

Let us understand the characteristics of the financial instruments

a) Liquidity: Financial instruments provide liquidity. These can be easily and quickly converted into cash

b) Collateral value: Financial instruments can be pledged for getting loans.

c) Transferability: Financial instruments can be easily transferred from person to person

d) Trading- Financial instruments facilitate easy trading in the market

4) **Financial Services:** Financial services include the services offered by both types of companies – Asset Management Companies and Liability Management Companies. The former include the leasing companies, mutual funds, merchant bankers, issue/portfolio managers. The latter comprises the bill discounting houses and acceptance houses. The financial services help not only to raise the required funds but also ensure their efficient deployment. They help to decide the financing mix and extend their services up to the stage of servicing of lenders. In order to ensure an efficient management of funds, services such as bill discounting, factoring of debtors, parking of short term funds in the money market, e-commerce and securitisation of debts are provided by the financial services firms. Besides banking and insurance, this sector provides specialised services such as credit rating, venture capital financing, lease financing, factoring, mutual funds, merchant banking, stock lending, depository, credit cards, housing finance, book building, etc. There are specialized institutions such as Asset Reconstruction Companies, Credit Information Companies which are also the main players in the financial services. These services are provided by stock exchanges, specialised and general financial institutions, banks and insurance companies, and are regulated by the Securities and Exchange Board of India (SEBI), Reserve Bank of India and the Department of Banking and Insurance, Government of India, through a plethora of legislations. As the main focus of this course is on financial services, you will have an opportunity to know more about these financial service

companies and the services offered by them in the subsequent Units and Blocks.

Financial institutions and financial markets facilitate the functioning of the financial system through financial instruments. In short objective of financial services is to Intermediate and facilitate financial transactions of individuals and institutional Investors. In order to fulfill the tasks assigned, they require number of services of financial nature. Financial services are, therefore, regarded as the fourth element of the financial system. An efficient and well ordered functioning of the financial system depends a great deal on the range of financial services extended by the providers and their efficiency and effectiveness.

1.2 FINANCIAL MARKETS: AN INTRODUCTION

The term 'market' usually brings to mind a geographical place where people exchange goods and services. However, it is a narrow view of market and does not reflect that the term market includes mechanisms also. Financial market, like any other market; facilitates the exchange of financial assets among the dealers. In other words, it refers to place or mechanism where financial assets are sold and purchased. Further, financial market transaction may be at specific place or location, for example stock exchange or the same may be just through a particular mechanism like telephone, telex, or any other electronic media. To enter the share market as a trader or investor, one must open a demat account (Account for holding shares /securities in electronic form) or brokerage account for brokers. Without a demat account one cannot trade in the stock market. The demat account works like a bank account where money is held to use for trading. The securities bought are maintained electronically in the demat account.

Financial markets are the centres or arrangements that provide facilities for buying and selling of financial claims and services. These are the markets in which money as well as monetary claim is traded in. Financial markets facilitate trading in financial assets. These assets are also referred to as financial instruments or securities. Unlike goods or services, financial assets are not consumed. These are claims against the money and enable their holders, upon disposing off the claims, to obtain consumable goods or services. Since financial assets are not consumed, what is bought and sold is their use for a particular period of time.

The participants in the financial markets are corporations, financial institutions, individuals and the government. These participants trade in financial products in these markets. They trade either directly or through brokers and dealers. In short, financial markets are markets that deal in financial assets and credit instruments. In other markets, goods and services are exchanged through price mechanism. Similarly in the financial markets, the price for the use of investible funds is the interest paid on a loan. The interest payable depends upon various factors like; size of the fund, length of the period of loan, risk involved, etc. Thus, the rate of interest, often known *as discount rate,* is the rate charged to obtain present funds in exchange for future funds.

1.3 ROLE OF FINANCIAL MARKETS

All the countries, irrespective of their state of development, need funds for their economic development and growth. In the economy, these funds are obtained from the savers or 'surplus units (the units which have more income than their consumption) which may be Household individuals, Business firms, Public sector units, Central Government, State Governments, Local Governments, Semi-Governments, etc.. At any point in time, we have people that have money that they don't want to spend but rather save for future uses. This set of people choose to save because they have more than what they needed to spend for the time being. On the other hand, there are people who want to spend money to undertake some economic activities but don't have the required amount of financial resources. Therefore, Financial markets play a significant role in transferring these surplus from savers (lenders) to 'borrowers (investors). This role of transferring financial resources from the surplus units to the deficit units is what is referred to as financial intermediation. Thus, a Financial Market comprises of all institutions that play the role of financial intermediation.

Financial Markets play an important role in promoting economic growth. It is commonly argued in the economic literature that a well-functioning financial sector creates strong incentives for investment and also fosters trade and business linkages thereby facilitating improved resource use and technological diffusion. By mobilizing savings for productive investment and facilitating capital inflows, financial markets stimulate investment in both physical and human resources.

In an economy, flow of surplus funds from surplus units to deficit units is essential for desired achievement of national goals and priorities. Thus, this flow must be in right direction and for productive purposes. For this, appropriate financial instruments and opportunities must be available. The financial markets provide the platform for such flow' where each saver can find and exchange the appropriate financial assets as per his/her requirement. So, the efficiency of financial market depends upon how efficiently the flow of funds is managed in an economy. Further, the financial market must induce people to become producers/entrepreneurs and motivate individuals and institutions to save more.

The most common method of raising capital by new companies is through sale of securities to the public. It is called public issue. Corporate enterprises and Govt. raises long term funds from the primary market by issuing financial securities. Both the new companies and the existing companies can issue new securities on the primary market. When an existing company wants to raise additional capital, securities are first offered to the existing shareholders on a preemptive basis. It is called rights issue. Private placement is a way of selling securities privately to a small group of investors.

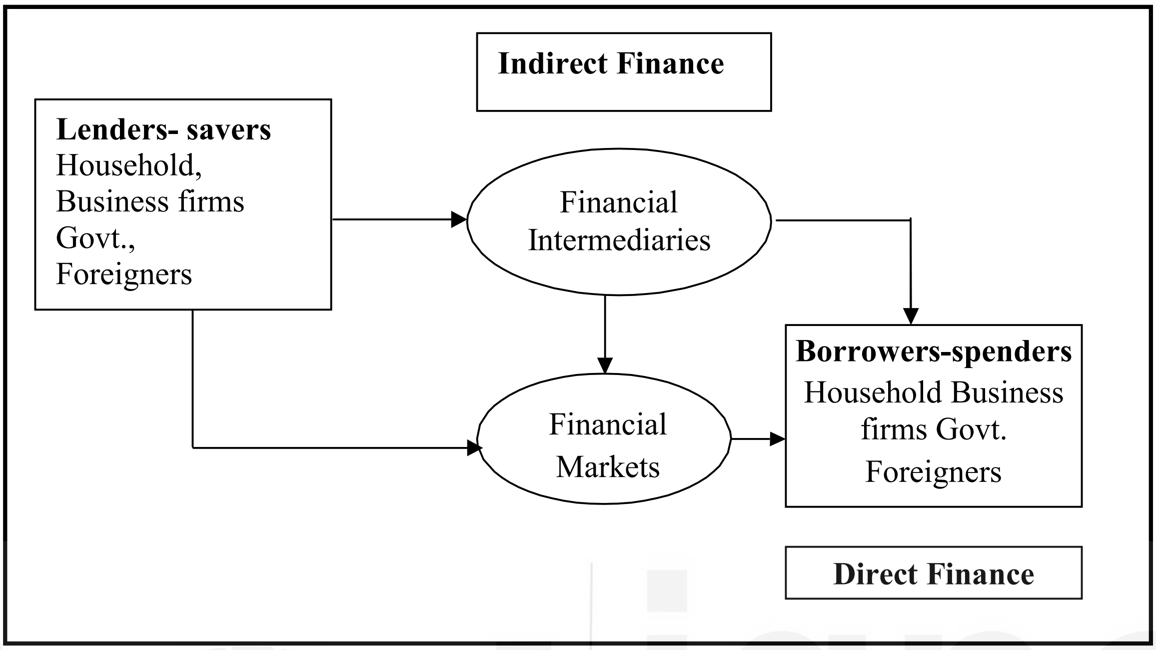

Figure : 1.2: Flow of funds from lenders to borrowers

The Figure 1.2 is simplified form of the flow of funds from saving-surplus units (ultimate lenders) to saving-deficit units (ultimate borrowers). The flow of funds moves from left to right, either directly though financial markets or indirectly through financial intermediaries. A financial market helps to link the savers and the investors by mobilizing funds between them. In doing so it performs what is known as an allocative function.

The financial markets not only help in the fast growth of industry and economy but also contribute to the society's well being and raising of the standard of living. So financial markets should grow at a fast rate. Moreover, they should be efficient and more diversified. As rightly pointed out by a financial expert, "The more varied the vehicle by which savings can flow from ultimate savers to ultimate users of funds, the more efficient the financial markets or an economy tend to be". In brief, the financial market plays a significant role in the allocation of the economy's savings in efficient production of goods and services, and thus, assist in achieving the desired national objectives.

1.4 FUNCTIONS OF FINANCIAL MARKETS

Functions of a financial market can be classified into two categories: Economic Functions and Financial Functions.

a) Economic Functions

- It facilitates the transfer of real economic resources from lenders to ultimate borrowers.
- Lenders can increase their income by investing their surplus resources.

- Borrowers on the other hand can also increase their earning by investing the borrowed funds in productive activity. This will also increase the gross national product.
- By facilitating transfer of real resources, it serves the economy and finally the welfare of the general public.
- It provides a channel through which new savings flow into capital formation of country.

b) Financial Functions

- It provides the borrowers with funds which they need to carry out their plans.
- It provides the lenders with earning assets so that their wealth may be held in a productive form without the necessity of direct ownership of real assets.
- It provides liquidity in the market through which the claims against money can be converted in to cash.

In addition to the above, the financial markets perform three more economic functions: ***First,*** the interaction of buyers and sellers in a financial market determines the price of the traded asset; thus, the required return on a financial asset can be determined. Financial market allows sellers and buyers to set the market price of a tradable asset. That is because the price discovery mechanisms set out what sellers intend to acknowledge, and what buyers intend to pay.

Second, Financial markets facilitate easy purchase and sale of financial assets. In doing so they provide liquidity to financial assets, so that they can be easily converted into cash whenever required. Holders of assets can readily sell their financial assets through the mechanism of the financial market. In the absence of liquidity, the owner will be forced to hold a debt instrument till it matures and an equity instrument till the company is, either voluntarily or otherwise, liquidated. While all financial markets provide some form of liquidity, the degree of liquidity is one of the factors that characterize different markets.

The ***third*** financial function of a financial market is that it provides not only valuable information about securities being traded in the market but also results in saving time, effort and money that both buyers and sellers of a financial asset would have to otherwise spend to try and find each other. The financial market is thus, a common platform where buyers and sellers can meet for fulfillment of their individual needs. Financial markets are classified on the basis of the maturity of financial instruments traded in them. Instruments with a maturity of less than one year are traded in the money market. Instruments with longer maturity are traded in the capital market.

Activity 1.1

i) What do you mean by the term price discovery process?

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ii) Explain the functions of a financial market?

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1.4.1 Classification of Financial Markets

Financial markets are classified in multiple ways. The most common method adopted is on the basis of maturity and trading. On these two criteria markets are classified under four segments. Apart from this markets are classified as organised markets and unorganized markets.

The classification of financial markets in an economy is shown in Figure 1.3. From the Figure 1.3, you can see two classifications i.e. based on maturity structure and trading structure. The maturity structure is subdivided into money market and capital market. The trading structure is further divided into primary market and secondary market.

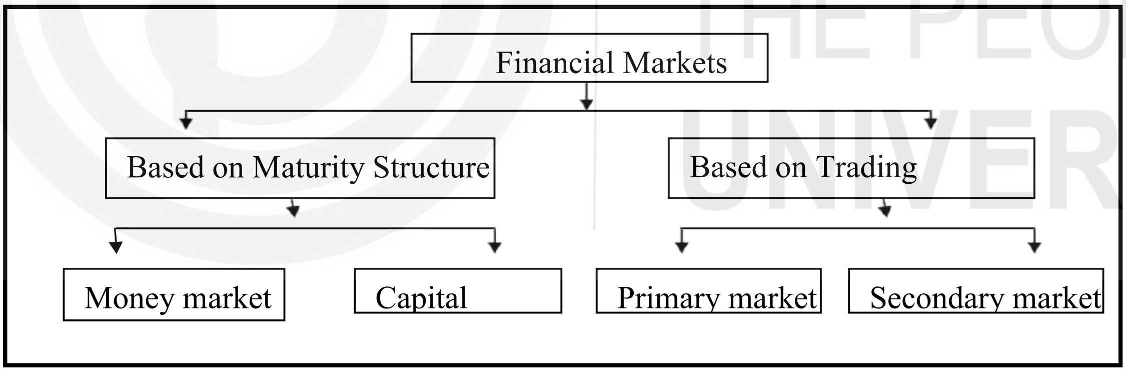

Figure 1.3: Structure of Financial Market Money and Capital Markets

a) ***Money Market:*** The money market is the place or mechanism where short term instruments that mature in a year or earlier are traded. The money market facilitates short-term financing and assures the liquidity of short-term financial assets. The money market is a main place for Central bank activities. It is significant in indicating changes in short-term interest rates, monetary policy and availability of short-term credit.

The focus of money market is on providing a means by which individuals, institutions and government are able to rapidly adjust their actual liquidity position to the amount desired. It is a medium through which holders of temporary cash surpluses meet those with temporary cash deficits. Hence, an individual with a temporary excess of investible funds is able to use the money market as a place, where his funds may be invested for a short period of time and yield return on them. Similarly, individuals, institutions and government with a temporary shortfall of liquidity can raise funds in the money market for a short period of time. The money market assures borrowers that they can obtain short-term funds quickly and it assures lenders that they can convert their short-term financial assets into cash. The central bank which is responsible for regulating and controlling the money supply in economy conducts most of its operations in the money market. The risk of capital losses (money risk) and risk of default are minimized in the money market. Money risk is low because the money market instruments are short-term in nature. This is so, because a change in interest rates does not affect their prices very much as the assured maturity is discounted over a short period of time. The risk of default or credit risk is low because money market instruments are mostly the liabilities of the government, central bank and commercial banks.

Money market meets the working capital requirements of industry, trade and commerce. Long term requirements of industries are not met by the money market instruments. The money market consists of specialised sub-markets and it consists of central bank, commercial banks, cooperative banks, saving banks, discount houses, acceptance houses, bill market, bullion market, etc. The central bank occupies a pivotal position in the money market. It is regarded as 'presiding deity' of money markets. RBI is the most important constituent in the money market. By virtue of the implication for the conduct of monetary policy, money market comes within the direct purview of RBI regulation. The primary aim of the Reserve Bank of India's operations in the money market is to ensure that the liquidity and short-term interest rates are maintained at levels consistent with the monetary policy objectives of maintaining price stability, ensuring adequate flow of credit to productive sectors of the economy and bringing about orderly conditions in the foreign exchange market. The Reserve Bank of India influences liquidity and interest rates through a number of operating instruments, viz., cash reserve requirements of banks, operation of refinance schemes, conduct of open market operations, repo transactions, changes in the Bank Rate, and at times through foreign exchange swap operations. The money market provides various kinds' of credit instruments which suits the various investors and thus augment the supply of funds. For further understanding of money market please go through para 1.6.1 of this unit.

b) Capital Market

Capital market is a market where buyers and sellers engage in trade of financial securities like ordinary shares, bond, debentures and securities of the government. etc. The buying/selling is undertaken by participants such as individuals and institutions. While from a broader perspective, Capital Market is viewed as a market of financial assets with long or infinite maturity, it actually plays a very important role in mobilizing resources and allocating them to productive channels. It converts financial assets into productive physical assets. It provides incentives to savers in the form of interest or dividend to the investors. It leads to capital formation. In recent years there has been a substantial growth in the Capital Market. The market consists of a number of players. They are categorized as:

- Companies
- Financial Intermediaries
- Investors

The players in the capital market channelize the supply and demand for the long-term capital. The constituents of the capital markets are, the stock exchange, commercial banks, cooperative banks, development banks, insurance companies, investment trusts and companies etc.

Important functions and significance of the capital markets are-

i) ***Growth of economy*** -The capital market helps in the proper allocation of resources from the people who have surplus funds to those who are in need of funds Therefore it helps in the expansion of industry and trade' of both public and private sectors leading to balanced economic growth in the country.

ii) ***Promotion of Saving Habits***: After the development of capital markets and the banking institutions it provides facilities and provisions to the investors to save more. In the absence of Capital Markets, people with surplus funds might have invested in unproductive assets like land or gold or might have indulged in unnecessary spending.

iii) ***Stable prices stocks:*** Apart from the mobilization of funds, capital markets help to stabilize the prices of stocks. Reduction in speculative activities and providing capital to borrowers at a lower interest rate help in the stabilization of the security prices.

iv) ***Ease of availability of Funds:*** Investments are made in Capital Markets on a continuous basis. Both the buyers and sellers interact and trade their capital and assets through an online platform. Stock Exchanges like NSE and BSE provide the platform for this and thus the transactions in the capital market become easy.

Comparison of Money Market and Capital Market

Money Market	Capital Market
Money market is a market for short-term funds. The short-term is defined as a period of 364 days or less. In other words, the borrowing and repayment take place in 364 days or less.	Capital market mainly deals in the trading of medium and long term securities wherein the maturity period is more than one year
Money market has no geographical constraints as that of a stock exchange. The financial institutions dealing in monetary assets may be spread over a wide geographical area. Even though there are various centers of money market such as Mumbai, Calcutta, Chennai, etc., they are not separate independent markets but are inter-linked and inter- related.	While the money markets are informal in nature the capital markets are formal in nature.
It is not a single homogeneous market. There are various sub-markets such as Call money market, Bill market, etc. The expected returns are lower in this market due to shorter duration	Expected returns are higher due to possibility of capital gains in the long term and regular dividends or bonus etc.
Money market establishes a link between RBI and banks and provides information of monetary policy and management. Instruments such as treasury bills commercial bills, certificate of deposits and other short term securities are traded.	Instruments traded in capital market include equity shares, preference shares, debentures bonds, and other long-term securities. Moreover the capital market securities are less liquid in comparison to money market securities.
At present, scheduled commercial banks, cooperative banks, Discount and Finance House of India (DFHI) are participating in the money market both as lenders and	Capital market securities involve greater risk in terms of repayment of the principal amount.

borrowers of short-term funds, while Life Insurance Corporation of India (LIC), Unit Trust of India (UTI), General Insurance Corporation of India (GIC), Industrial Development Bank of India (IDBI) and National Bank for Agriculture and Rural Development (NABARD) are participating as lenders. Money market securities are less risky due to short period and sound financial position of the issuers	

Primary and Secondary Markets

The main components of the capital market in India are:

1) Primary Market -New-issue Market (Public issues)
2) Secondary Market (Stock Market)

1) Primary Market

Primary Market is a market for new issues or new financial claims. Hence, it is also called New Issue Market. The primary market deals with these securities which are issued to the public for the first time. There are three ways by which a company may raise capital in a primary market. They are:

a) Public issue
b) Rights issue
c) Private Placement

2) Secondary Market

Secondary Market is a market for secondary sale of securities. In other words, securities which have already passed through the new issue market are traded in this market. Generally, such securities are quoted in the Stock Exchange and it provides a continuous and regular market for buying and selling of securities. This market consists of all stock exchanges recognized by the Government of India. The stock exchanges in India are regulated under the Securities Contracts (Regulation) Act, 1956. The Bombay Stock Exchange is the principal stock exchange in India which sets the tone of the other stock markets. The active secondary market stimulates the activity in the primary market also. The level of development in the secondary market determines the efficiency and growth of the primary market.

The main difference between primary market and secondary market is given below:

Comparison between Primary market and Secondary market

Primary Market (New Issue Market)	Secondary Market
Sale of securities by new companies for raising capital is undertaken.	In this market trading of existing shares only is undertaken.
Securities are sold by the company to the investor directly (or through an intermediary).	Ownership of existing securities is exchanged between investors. The company is not involved at all.
The primary market directly promotes capital formation.	The secondary market indirectly promotes capital formation. Enhances encash ability (liquidity) of shares.
The activity in this market is for buying of securities, the securities cannot be sold there.	Both buying and selling of securities is undertaken through the stock exchange.
Price for a new issue is determined and decided by the management of the company.	Prices are determined by demand and supply for the security.
There is no fixed geographical location.	Located at specified places.

Organized Markets and Unorganized markets

Organized Markets

The organized sector, comprises the Reserve Bank of India, the commercial banks (both nationalized and private), the foreign banks and the cooperative banks. The financial institutions like LIC, GIC, UTI and mutual funds are the other institutions which operate in the organized sector. Regional rural banks, chit funds and post office. Savings banks also play a significant role in the semi-urban areas and small towns.

Unorganised markets

The unorganized sector consists of the indigenous bankers and the money lenders called mahajans, seths, shroffs, chettiars, etc. who pursue the banking business on traditional lines and their practices and operations vary from place to place. Many of the indigenous bankers combine banking business with trading and commission business, and mostly deal in hundis' and promissory notes.

Activity 1.2

Differentiate between:

i) Money Market and Capital Market.

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ii) Primary Market and Secondary Market.

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1.5 INDIAN MONEY AND CAPITAL MARKETS

Financial markets are classified into two, namely, money market and capital market**.**

1.5.1 Money Market- sub markets and participants

Money markets play a key role in banks' liquidity management and the transmission of monetary policy. The money market is a market for short-term funds, which deals in financial assets. The period of maturity of assets dealt in this market is up to one year. Money market does not deal in cash or money it simply provides a market for credit instruments such as bills of exchange, promissory notes, commercial paper, treasury bills, etc.

The money market in India consists of submarket which is shown below in Figure 1.6

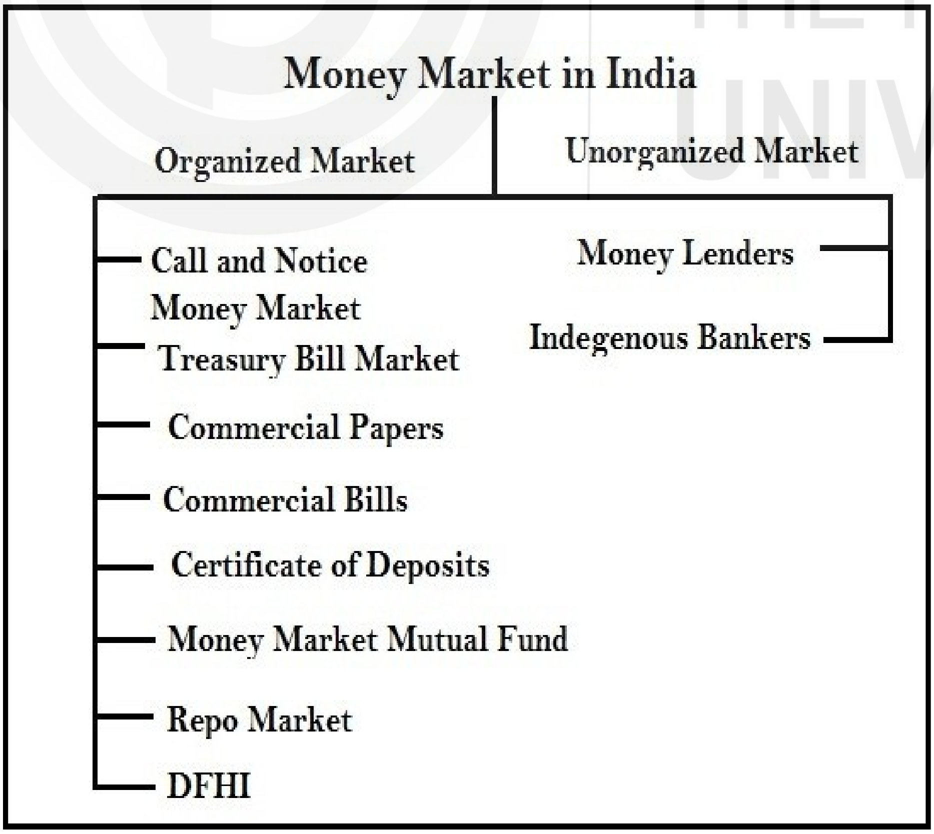

Figure 1.4: Sub markets of money market

1) Call and notice Money Market

"Call Money" means borrowing or lending in unsecured funds on overnight basis; "Notice Money" means borrowing or lending in unsecured funds for tenors up to and inclusive of 14 days excluding overnight borrowing or lending; "Term Money" means borrowing or lending in unsecured funds for periods exceeding 14 days and up to one year. The transactions in money market are undertaken on telephone, fax or Internet. The Indian money market consists of Reserve Bank of India, Commercial banks, Co- operative banks, and other specialized Financial Institutions. The Reserve Bank of India is the leader of the money market in India. Some Non- Banking Financial Companies (NBFCs) and financial institutions like LIC, GIC, UTI, etc. also operate in the Indian money market.

Participants

The following entities can participate in the Call, Notice and Term Money Markets, both as borrowers and lenders:

a) Scheduled Commercial Banks (excluding Local Area Banks);
b) Payment Banks;
c) Small Finance Banks;
d) Regional Rural Banks;
e) State Co-operative Banks, District Central Co-operative Banks and Urban Co- operative Banks, and
f) Primary Dealers

The call/notice money market forms an important segment of the Indian money market. Call money is required mostly by banks. Commercial banks borrow money without collateral from other banks in order to maintain a minimum cash balance known as cash reserve ratio (CRR). In this market surplus funds of financial institutions and banks are traded. In India call money markets are mainly located in commercial centres like Mumbai, Kolkata, Chennai, Delhi and Ahmadabad.

2) Treasury Bill Market

This is a market for sale and purchase of short term government securities. These securities are called as Treasury Bills (T-Bills) which are promissory notes or financial bills issued by the RBI on behalf of the Government of India. There are two types of treasury bills. (i) Ordinary or Regular Treasury Bills and (ii) Ad Hoc Treasury Bills. The maturity period of these securities range from as low as 14 days to as high as 364 days. A Treasury bill is a promissory note. The advantage of Treasury bills is that they are highly liquid instruments; the holder of treasury bills can transfer it or get it discounted from RBI. These bills are normally issued at a price less than their face value; and redeemed at face value. So the difference between the issue price and the face value of the Treasury bill represents the interest on the investment. T-Bills are issued through a bidding process at auctions. Banks, Financial institutions and corporations normally play major role in the Treasury bill market

3) Commercial Paper

Commercial Paper Market is another segment of money market. It is a market which deals in commercial papers. Commercial paper (CP) is a popular instrument for financing working capital requirements of companies. Commercial papers are unsecured short term promissory notes issued by reputed, well established and big companies having high credit rating. They can be issued to (or purchased by) individuals, banks, companies and other registered Indian corporate bodies. They are issued for period ranging from 15 days to one year. Commercial papers are transferable by endorsement and delivery.

4) Commercial Bill Market

When goods are sold on credit, the seller draws a bill of exchange on the buyer for the amount due. The buyer accepts it immediately and agrees to pay the amount mentioned therein after a certain specified date. This bill is called trade bill. The seller of goods have an option to retain the bill till maturity or get it discounted through a banker so that the can get cash immediately. When trade bills are accepted by commercial banks, they are called commercial bills. The bank discounts the bills given by their clients. A certain amount known as discount is deducted from the amount of the bill and balance is paid to the client (seller). Commercial bills are widely used in both domestic and foreign trade to discharge the business obligations.

5) Certificates of Deposits Market (CD)

CD is a certificate in the form of promissory note issued by banks against the short term deposits of companies and institutions, received by the bank. Simply stated, it is a time deposit of specific maturity and is easily transferable. It is a document of title to a time deposit. It is issued as a bearer instrument and is negotiable in the market. It is payable on a fixed date. It has a maturity period ranging from three to twelve months. It is issued at a discount. The discount rate is determined by the issuing bank and the market. Banks and financial institutions are major issuers of CD. Banks can raise money so as to increase their lending capacity. The CD market provides an opportunity for banks with surplus funds to invest and maximize their earnings. CDs can be issued to individuals, corporations, companies (including banks and Primary Dealers), trusts, funds, associations, etc. Non-Resident Indians (NRIs) may also subscribe to CDs, but only on non-repatriable basis, which should be clearly stated on the Certificate

6) Money Market Mutual Funds

Money market mutual funds (MMMF) are used to manage short-term cash needs. These funds are open-ended in the debt fund category and deal only in cash or cash equivalents. Money market securities have an average maturity of one-year; that is why these are termed as money market instruments. They were introduced in India in April 1991 to provide an additional short-term avenue to investors and to bring money market instruments within the reach of individuals. In October 1997, MMMFs were permitted to invest in rated corporate bonds and debentures with a residual maturity of up to one year, within the ceiling existing for Commercial Paper (CPs). The minimum lock-in period was also reduced gradually to 15 days, making the scheme more attractive to investors. A significant feature of MMMFs or liquid Mutual Funds in India is that they have been mainly catering to the short-term investment needs of institutional investors such as corporate and banks whose redemption requirements are large and simultaneous.

7) Repurchase Agreements (REPO)

Repurchase agreements, or repos, are a form of short-term borrowing used in the money markets, which involve the purchase of securities with an agreement to sell them back at a specific date, usually for a higher price. The difference between the purchase price and the original price is the cost for the borrower. This cost of borrowing is called repo rate. In simple terms, it is an exchange of a security (which acts as collateral) for cash. Repurchase agreements are commonly used to provide short-term liquidity.

A transaction is called a Repo when viewed from the perspective of the seller of the securities and reverse when described from the point of view of the suppliers of funds. Thus whether a given agreement is termed Repo or Reverse Repo depends largely on which party initiated the transaction. Thus Repo is a transaction in which a participant (borrower) acquires immediate funds by selling securities and simultaneously agrees to repurchase the same or similar securities after a specified period at a specified price. It is also called *ready forward contract*.

8) Discount and Finance House of India

Discount & Finance House of India Limited was set up by the Reserve Bank of India (RBI), jointly with Public Sector Banks and All-India Financial Institutions, as a sequel to Vaghul Working Group recommendations, to deal in money market instruments. DFHI participates in transactions in all the market segments, it borrows and lends in the call, notice and term money market, purchases and sells treasury bills sold at auctions, commercial bills, CDs and CPs. The presence of DFHI as an intermediary in the money market has helped the corporate entities, banks, and financial institutions to invest their short-term surpluses in money market instruments. DFHI provides liquidity to money market instruments and facilitates money market transactions of small and medium sized institutions that are not regular participants in the market.

Unorganized market

Money lenders

Money-lending is probably the oldest form of business in the rural areas of India. In spite of the spread of the banking network, the village mahajan continues to be an indispensable source of credit. Money-lending laws were introduced by some of the State Govts. with an intention to curb non-regulated indigenous lenders from charging exorbitant interest rates to borrowers. These laws typically require licensing of money lenders, impose a ceiling on rate of interest that money lenders can charge, and generally provide that a court shall not take cognizance of a matter filed by an unlicensed money lender. Even though getting a valid license under the Money Lending Act helps money lenders to carry on business lawfully and have legal recourse against the defaulters, one of the major reasons for non-registration is the ceiling on interest rate. Some of the money lenders are not even aware about the requirement of such registration.

Indigenous bankers

Indigenous bankers are private firms or individuals who operate as banks and as such both receive deposits and give loans. Like banks, they are also financial intermediaries. They may be termed as professional moneylenders whose primary business is not banking but money lending. The indigenous bankers have been playing a significant role in the economic life of India. When commercial banking had not developed, they were the main source of finance for agriculturists, traders, businessmen, small industrialists, etc.

After nationalization of commercial banks and the spread of banking in urban and rural areas, the activities of indigenous bankers have declined, but their importance has not become less because of the difficulties still faced by the borrowers in getting loans from the banks.

The borrowers approach them directly and informally and get loans promptly and easily. They do not have any fixed banking hours and do not enter into formalities and procedures followed by commercial banks in advancing loans. That is why they are still popular with traders, businessmen, agriculturists, and ordinary people. The indigenous bankers act as commission agents when they purchase agricultural products on behalf of firms, mills, and trading houses. In this way, they again help in the development of internal trade.

Activity 1.3

i) What is meant by Call money market?

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ii) What are Certificates of Deposits? How do they differ from fixed deposits in banks?

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iii) Explain in brief functions of Discount and Finance of India

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1.5.2 Capital Market- Functions and Participants

Capital market simply refers to a market for long term funds. These funds are subject to uncertainty and risk. Capital market is a vehicle through which long term finance is channelized for the various needs of industry, commerce, govt. and local authorities. It deals in ordinary shares, bonds, debentures and stocks and securities of the government. Capital markets play a crucial role in the economic development of a country. They provide financial resources required for the long-term sustainable development of the economy. Development of viable capital markets is therefore considered an important element in the macro-financial policy toolkit, including for objectives such as financial stability and the transmission of monetary policy.

Functions of a capital market

1) Facilitates long term investments by mobilizing long term savings.
2) Provides risk capital in the form of equity or quasi-equity to companies/entrepreneurs.
3) Provides liquidity platform enabling the investor to sell financial assets.
4) Provision of information efficiently to enable participants to undertake an informed opinion about investment, disinvestment, reinvestment etc.
5) Provides a platform for quick valuation of instruments – both equity and debt.
6) Safety of investors is ensured through insurance against market risk, through derivative trading and default risk through investment protection

fund.

7) Operational efficiency is ensured through: (a) simplified transaction procedures, lowering settlement times, and (c) lowering transaction costs.

Players or Participants of Capital Market

As already stated, there are many players in the capital market. We will discuss about a few important players as stated below-

a) Companies

b) Financial Intermediaries

c) Investors

a. Companies:- Generally every public company can access the capital market. The companies which are in need of finance for their projects can approach the market. The companies can mobilise the resources for their long-term needs such as project cost, expansion and diversification of projects and other expenditure items. In India, the companies should get the prior permission from the SEBI (Securities Exchange Board of India) to raise the capital from the market.

b. Financial Intermediaries:- Financial intermediaries assist in the process of converting savings into capital formation in the country. The intermediaries occupy a dominant role in the capital formation which ultimately leads to the growth and prosperity. The major intermediaries in the capital market are:

i) Merchant bankers

ii) Registrar to the Issue

iii) Bankers

iv) Brokers and sub-brokers

v) Underwriters

i) **Merchant bankers:** Merchant bankers play an important role in attracting public funds to capital issues. They act as issue managers, lead managers or co-managers

ii) **Registrars to the issue**: Registrars are intermediaries who undertake all activities connected with new issue management. They are appointed by the company in consultation with the merchant bankers to the issue.

iii) **Bankers:** Some commercial banks act as collecting agents and some act as coordinating bankers. Some bankers act as merchant bankers and some are brokers. They play an important role in transfer, transmission and safe custody of funds.

iv) **Brokers**: They act as intermediaries in purchase and sale of securities in the primary and secondary markets. They have a network of sub brokers spread throughout the length and breadth of the country.

v) **Underwriters**: Generally, investment bankers act as underwriters. They at times agree to take a specified number of shares or debentures offered to the public, if the issue is not fully subscribed by the public. Underwriters may be financial institutions, banks, mutual funds, brokers etc.

c) Investors- The capital market consists of large number of investors. The basic objectives of an investor are to get good returns on his/her investment. An investor may desire to take away the fund/s after a specific period. Therefore, safety is the most important factor while considering the investment proposal. The investors comprise of financial and investment companies and the general public companies. Usually, the individual savers are also treated as investors. Return is the reward to the investors.

1.5.3 Components of Capital Market

There are four main components of capital market. They are: (a) Primary market, (b) Government Securities Market, (c) Financial Institutions, and (d) Secondary Market.

a) Primary Market /New Issue Market (NIM)

We have already discussed about Primary market in para 1.4 of this unit therefore it is not discussed here again

b) Government Securities Market

This is another constituent of the capital market. The govt. borrows funds from banks, financial institutions and the public, to finance its expenditure in excess of its revenues. Main sources of borrowing funds are issuing Govt. securities. which are issued by central government, state governments, semi-government bodies, public sector corporations and financial institutions such as IDBI, IFCI, SFCs, etc. in the form of marketable debt.

A Government Security (G-Sec) is a tradable instrument issued by the Central Government or the State Governments. It acknowledges the Government's debt obligation. Such securities are short term (usually called treasury bills, with original maturities of less than one year) or long term (usually called Government bonds or dated securities with original maturity of one year or more). In India, the Central Government issues both, treasury bills and bonds or dated securities while the State Governments issue only bonds or dated securities, which are called the State Development Loans (SDLs). G-Secs carry practically no risk of default and, hence, are called risk-free gilt-edged instruments.

Major participants in the G-Secs (Government Securities) market historically have been large institutional investors. The G-Secs market has witnessed significant changes during the past decade. Introduction of an electronic screen-based trading system, dematerialized holding, straight through processing, establishment of the Clearing Corporation of India Ltd. (CCIL) as the Central Counter Party (CCP) for guaranteed settlement, new instruments, and changes in the legal environment are some of the major aspects that have contributed to the rapid development of the G-Sec market.

Major players in the G-Secs market

The Government securities are issued by Central Government, State Governments and Local Self Governments which includes the authorities like; Municipalities, Autonomous Institutions like; Port Trusts, Improvement Trusts, State Electricity Boards, Metropolitan Authorities, Public Sector Corporations and other Government Agencies like; IDBI, IFCI, SFCs. SIDCs, Housing Boards, etc. The government securities market happens to be an overwhelmingly significant part of the stock market in India.

Primary Dealers (PDs) play an important role as market makers in G-Secs market. A market maker provides firm two-way quotes in the market i.e. both buy and sell executable quotes for the concerned securities. Other participants include co-operative banks, regional rural banks, mutual funds, provident and pension funds. Foreign Portfolio Investors (FPIs) are allowed to participate in the G-Secs market within the quantitative limits prescribed from time to time. Corporates also buy/ sell the G-Secs to manage their overall portfolio.

c) Financial Institutions

Financial institutions are the most active constituent of the Indian capital market. Financial institutions are divided into banking and non-banking institutions. While the banking system in India comprises the commercial banks and co-operative banks, the examples of non-banking financial institutions are Life Insurance Corporation (LIC), Unit Trust of India (UTI) and Industrial Development Bank of India (IDBI). Apart from this there are Non-banking financial corporations The banking institutions participate in the economy's payments mechanism, i.e., they provide transaction services, their deposit liabilities constitute a major part of the national money supply, and they can, as a whole, create deposits or credit, which is money. There are special financial institutions which provide medium and long term loans to big business houses. Such institutions help in promoting new companies, expansion and development of existing companies etc. The main special financial institutions of the Indian capital market are IDBI, IFCI, ICICI, UTI, LIC, NIDC (National Industrial Development Corporation), SFCs (State Financial Corporations) etc.

d) Secondary Market

The investors want liquidity for their investments. There are buyers and sellers of securities. There should be a place where securities of different companies can be bought and sold. Secondary market provides such a place. Secondary Market is a market for secondary sale of securities. In other words, securities which have already passed through the new issue market are traded in this market. Generally, such securities are quoted in the Stock Exchange and it provides a continuous and regular market for buying and selling of securities. This market consists of all stock exchanges recognised by the Government of India.

1.5.4 New Financial Instruments in the Capital Market

With the evolution of the capital market, new financial instruments are being introduced to suit the requirements of the market. Some of the new financial instruments introduced in recent years may be briefly explained as below:

1) **Floating rate bonds:** Generally, bonds come with a fixed coupon or interest rate. The interest rate on these bonds is not fixed. However, a floating rate bond is a debt instrument that does not have a fixed coupon rate, but its interest rate fluctuates based on the benchmark the bond is drawn. For example, the RBI issued a floating rate bond in 2020 with interest payable every six months. After six months, the interest rate is re-fixed by the RBI. The benchmark for the floating rate bond is 35 points higher than the prevailing National Saving Certificate (NSC) interest rate. The current interest rate (Jan – March 2022) for the National Savings Certificate is 6.8%. Hence, the interest rate for the RBI's floating rate bond is 6.8% + 0.35% = 7.15%.

2) **Zero interest bonds:** A coupon is a periodic interest received by a bondholder from the time of issuance of the bond till maturity. Zero coupon bonds, also known as discount bonds, do not pay any interest to the bondholders. Instead, you get a large discount on the face value of the bond.

   On maturity, the bondholder receives the face value of his investment. In simple words, the investor purchasing a zero coupon bond profits from the difference between the buying price and the face value, contrary to the usual interest income.

3) **Deep discount bonds**: These bonds are sold at a large discount while issuing them. These are zero coupon bonds whose maturity is very high (say, 15/20 years). There is no interest payment. The classic example is that of bonds issued by IDBI in 1992. Investors were drawn to exciting advertising by Industrial Development Bank of India (IDBI), a Central Government promoted Development Financial Institution, calling for subscription to its Flexi-Bonds. The terms were mouth-watering, offering bonds with a face value of Rs. 1 lakh for Rs. 2,700. The face value of Rs. 1 lakh on each bond would be paid to the investor in 25 years was the offer. However, these bonds are not popular now. In the past IDBI & SIDBI had issued this instrument. for a deep discount price of Rs.5,300 in IDBI the investor got a bond with the face value of Rs.2,00,000.

4) **Secured Premium Notes (SPN):** Secured premium Note is a kind of non-convertible debenture (NCD) attached with warrant (i.e. option). SPN is a hybrid security i.e. it combines both features of equity and debt products. SPN can be only issued by the listed companies after having approval from the Central Government These are issued along with a detachable warrant. This warrant gives the holder the right to apply for, or seek allotment of one equity share, provided the SPN is fully paid. The conversion of detachable warrant into equity shares is done within the time limit notified by the company. There is a lock in period during which no interest is paid for the invested amount. TISCO was the first company to issue SPN (in 1992) to the public along with the right issue. Essar Gujarat, Ranbaxy & Reliance are the other companies which had issued this type of instruments in past.

5) **Option bonds:** Option bonds are option contracts in which the underlying asset is a bond. A bond option allows investors the ability to hedge the risk of their bond portfolios or speculate on the direction of bond prices with limited risk.

6) **Warrants:** A share warrant is an option to the investor to buy a specified number of equity shares at a specified price over a specified period of time. The warrant holder has to surrender the warrant and pay some cash known as 'exercise price' of the warrant to purchase the shares. On exercising the option the warrant holder becomes a shareholder. Warrant is yet to gain popularity in India, due to the complex nature of the instrument.

7) **Preference shares with warrants:** These carry a certain number of warrants. The holder of warrant can apply for equity shares at premium at any time in one or more stages between the third and fifth year from the date of allotment.

8) **Zero interest fully convertible debentures**: No interest is paid to the investors till the lock in period is over. After a notified period, these debentures will be automatically and compulsorily converted into shares.

1.6 STOCK EXCHANGE

Stock market is a market place where investors can buy and sell securities. While the primary market deals with only new issue of shares, debentures and bonds, the secondary market provides a place for securities which have already been issued in an initial private or public offering. Stock exchange ensures continuous and ready market for the securities. After the securities are issued in primary market, they are traded in the secondary market by the companies issuing securities, investors, brokers etc. Stock exchanges provide the opportunity for small as well as large investors to own shares There has been vide ranging changes in the Indian securities market, especially in the secondary market. Technological advancement and online-based transactions have modernized the stock exchanges.

Stock exchanges are formal organizations, approved and regulated by the regulatory authorities of a country. Trading in securities can be undertaken only by the members of the stock exchange. For undertaking trading rules and regulations are prescribed for various types of transactions. There are **23** stock exchanges in India. Among them, two are national-level stock exchanges namely Bombay Stock exchange (BSE) and National Stock Exchange (NSE). The rest 21 are Regional Stock Exchanges (RSEs). As on 6^{th} February 2022 there are 9 active stock exchanges in India.

1.6.1 Major Stock Exchanges in India

In India the first organized stock exchange was Bombay Stock Exchange. It was started in 1877. Later on, the Ahmedabad Stock Exchange and Calcutta Stock Exchange were started in 1894 and 1908 respectively. Brief descriptions of major Stock Exchanges are given below:

1) Bombay Stock Exchange (BSE)

Bombay Stock Exchange (BSE) is the oldest and the largest stock exchange in Asia. Bombay Stock Exchange traces its history to the 1980s, when a dozen stockbrokers gathered under a banyan tree in front of Mumbai's Town Hall. As the number of brokers kept increasing this location kept changing and finally moved to Dalal Street in 1874. The Bombay Stock Exchange was recognised in May 1927 under the Bombay Securities Contracts Control Act of 1925. It is the first stock exchange in the country to secure permanent recognition from the Government of India in 1956 under the Securities Contracts (Regulation) Act of 1956.

BSE has started allowing its members to set-up computer terminals outside the city of Mumbai. In 2005, BSE was given the status of a fully fledged public limited company along with a new name as "Bombay Stock Exchange Limited". The BSE has computerized its trading system by introducing BOLT (Bombay on Line Trading) since March 1995. BSE is operating BOLT at 275 cities.

2) National Stock Exchange of India (NSE)

In the year 1991 Pherwani Committee recommended to establish National Stock Exchange (NSE) in India. In 1992 the Government of India authorised IDBI for establishing this exchange. However the trading started in 1994. It has a fully- automated screen-based electronic trading system. The NSE does not have trading floors as in conventional stock exchanges. The trading is entirely screen based with automated order machine. The screen provides entire market information at the press of a button. NSE is the first exchange in the world to use satellite communication technology for trading. Its trading system, called National Exchange for Automated Trading (NEAT), is a state of-the-art client server based application. The brokers can sit in their own offices and trade on the system which offers versatile trading solutions. The trading software provides all the options which are available on a trading floor or through telephone trades. The screen provides entire market information at the press of a button which the existing telephone trade or trading floor cannot provide instantaneously. As the system provides for concealment of the identity of market information continuously on a real time basis, it is a significant improvement over all the existing traditional trading systems. The screen gives all the required information about the depth of the market, the types of orders floating into the system, the best buy order value, the best buy price, the best sell price, the order value available at the best sells price, the last traded price, all previous trade that have taken place, outstanding orders of the concerned trading member, etc. Information is dynamically updated. As market participants sit in their own offices they have all advantages of the back office support and facility to get in touch with their constituents

3) Over the Counter Exchange of India (OTCEI)

The OTCEI was incorporated in October, 1990 as a Company under the Companies Act 1956. It became fully operational in 1992 with opening of a counter at Mumbai. It is recognised by the Government of India as a recognized stock exchange under the Securities Control and Regulation Act 1956. It was promoted jointly by the financial institutions like UTI, ICICI, IDBI, LIC, GIC, SBI, IFCI, etc. It was set up to provide small and medium sized enterprises access to the capital markets and to investors a convenient mode of investments. It is a ring less electronic national exchange listing entirely new companies, which will not be listed on any other exchange.

Companies engaged in investment, leasing, finance, hire purchase, amusement parks etc. and the companies listed on any other stock exchange are not eligible for getting listed on OTCEI. Also, listing is granted only if the issue is fully subscribed to by the public and sponsor. It handles both primary issues and secondary transactions especially of those securities which are not listed in stock exchanges. The Over the Counter market is a negotiated market, because prices are settled through individual bargaining between buyers and sellers. In OTC market the business is not conducted at any one place designated as market place. Some stocks trade in the Over the Counter Market because the company is small or unknown or the company simply does not wish to list the security on a stock exchange or stock is closely held. Thus, over the counter market is the only place where certain stocks can be purchased or sold. Small companies or companies that do not meet exchange listing requirements are traded in over the counter market that have limited marketability and liquidity.

Activity 1.4

i) Explain the components of capital market

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ii) Explain the main functions of a capital market

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iii) Briefly explain about the major intermediaries in the capital market.

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iv) Briefly explain about Over the Counter Exchange of India (OTCEI)

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1.7 GLOBALIZATION OF FINANCIAL MARKETS

Globalization means the integration of financial markets throughout the world into an international financial market. Because of the globalization of financial markets, entities in any country seeking to raise funds need not be limited to their domestic financial market, nor are investors in a country limited to the financial assets issued in their domestic market.

Over recent decades, there has been a steady increase in cross-border financial flows around the world. First, various financial institutions including banks and institutional investors have expanded their activities geographically. In this process, they acted as an intermediary to channel funds from lenders to borrowers across national borders. Second, the more mature securities markets have gained a clear cross-border orientation. In many instances, newly issued securities are designed and offered to the public in such a way as to maximise their appeal to international investors.

In the process of developing globalisation of financial markets seen over recent decades, both technological advances and financial innovation played a key role. In the past few decades, information systems have become able to compute and store more data more rapidly. Telecommunications networks have extended their ramifications and augmented their capacity while more reliable data exchange protocols have made it possible to connect computing machines in more efficient ways. As a result, cross- border financial deals have become both easier and more secure, effectively lowering the barrier constituted by distance, be it determined by geography or other factors. Investors can monitor global markets and simultaneously assess how this information will impact the risk/reward profile of their portfolios. Significantly improved computing power allows the instant manipulation of real-time market information so that attractive investment opportunities can be identified.

Moreover, particularly over the last two decades, financial markets have become breeding ground for a wide array of rapidly evolving financial products, often described generically as "derivative" instruments. These products make it possible for borrowers and lenders to customize their risk exposures as well as adjust them over time. With derivative products, borrowers and lenders can therefore mitigate some of the problems associated with asymmetries of information in financial markets, which are particularly acute in the international context.

The U.S. financial markets have shifted from being dominated by retail investors to being dominated by institutional investors. Retail investors are individuals, while institutional investors are financial institutions such as pension funds, insurance companies, investment companies, commercial banks, and savings and loan associations. The shifting of the financial markets in the U.S. and other major industrialized countries, from dominance by retail investors to institutional investors is referred to as the institutionalization of financial markets. Unlike retail investors, institutional investors have been more willing to transfer funds across national borders to improve the risk/reward opportunities of a portfolio that includes financial assets of foreign issuers. There has been increased participation in the financial markets of developing economies, popularly referred to as emerging markets.

1.7.1 Classification Of Global Financial Markets

While there is no uniform system for classifying the global financial markets, Figure 1.5 provides a schematic presentation of an appropriate classification system. From the perspective of a given country, financial markets can be classified as either internal or external

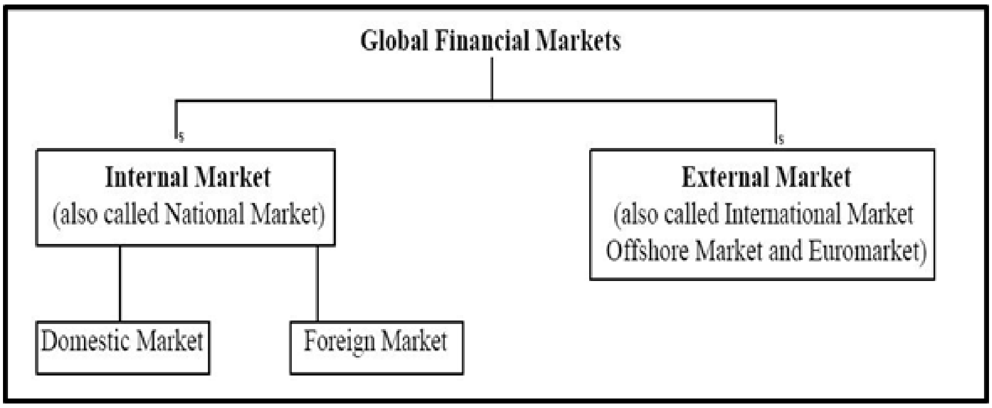

Figure: 1.5: Classification of Global Financial Markets

The internal market, also called the national market, can be divided into two parts, the domestic market and the foreign market. The domestic market is where issuers domiciled in the country where the securities are issued and where those securities are subsequently traded.

The foreign market of a country is where the securities of issuers not domiciled in the country are sold and traded. The rules governing the issuance of foreign securities are those imposed by regulatory authorities where the security is issued. For example, securities issued by Non-U.S. Corporation in the United States must comply with the regulations set forth in U.S. securities law. A non-Japanese corporation that seeks to offer securities in Japan must comply with Japanese securities law and regulations imposed by the Japanese Ministry of Finance. Nicknames have been used to describe the various foreign markets. For example, the foreign market in the U.S. is called the "Yankee market". The foreign market in Japan is nicknamed the "Samurai market", in the United Kingdom the "Bulldog market", in the Netherlands the "Rembrandt market", and in Spain the "Matador market".

The external market, also called the international market, includes securities with the following distinguishing features; at issuance they are offered simultaneously to investors in a number of countries; and they are issued outside the jurisdiction of any single country. The term offshore refers to a location outside of one's home country. The term is commonly used in the banking and financial sectors to describe areas where regulations are different from the home country. Offshore locations are generally island nations, where entities set up corporations, investments, and deposits. Companies and individuals (typically those with a high net worth) may move offshore for more favorable conditions, including tax avoidance, relaxed regulations, or asset protection. The external market is commonly referred to as the offshore market, or more popularly, the Euromarket.

Activity 1.5

i) What do you understand by the term globalisation of financial markets?

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ii) What are the specific reasons for globalization of financial markets?

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iii) What is an Offshore market? Explain

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1.8 SUMMARY

Financial system includes all those activities dealing in Finance, organised into a system. The financial system consists of Financial Institutions, Financial Markets, Financial Instruments and the Financial Services. Financial Institutions include both regulatory and intermediary institutions. Financial markets include both primary and secondary markets.

A financial market is a place or mechanism where funds or savings are transferred from surplus units to deficit unit. These markets can be broadly classified into money markets and capital markets. Money markets deal with short term claims or financial assets, whereas capital markets deal with those financial assets which have maturity period of more than a year. The functions of financial markets can be classified into two categories: Economic and Financial. From the perspective of a given country the global financial markets can be classified as either internal or external.

1.9 SELF ASSESSMENT QUESTIONS

1) What do you mean by 'Financial System'? Explain the various components of Financial System.
2) What is a Financial Market? Explain its Role and Functions.
3) Explain the meaning of 'Capital Market' and 'Money Market'. Also bring out the similarities and the difference between these two markets.
4) Write a detailed account of Indian Money and Capital Markets.
5) Explain the term Money Market and discuss the role of different

participants in a money market?

6) Explain the term ‘Capital Market’. Who are the various participants in capital market.

7) What are the various non-banking financial institutions that are involved in the Capital Market operations.

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UNIT 2 INTRODUCTION TO FINANCIAL SERVICES

Objectives

After reading this unit, you should be in a position to:

- explain the concept and meaning of financial services;
- discuss the significance of financial services;
- describe the various types of financial services;
- explain the impact of technology on the financial services sector; and
- enumerate the challenges before the financial services sector.

Structure

2.1 INTRODUCTION

India has a diversified financial sector undergoing rapid expansion, both in terms of strong growth of existing financial services firms and new entities entering the market. The sector comprises commercial banks, insurance companies, non-banking financial companies, co-operatives, pension funds, mutual funds and other smaller financial entities. The banking regulator has allowed new entities such as payment banks, small finance banks, thereby adding to the type of entities operating in the sector. The financial services sector provides financial services to people and corporations. This segment of the economy is made up of a variety of financial firms including banks, investment houses, lenders, finance companies, real estate brokers, and insurance companies.

Importance of the Financial Services Sector

The financial services sector is the main driver of a nation's economy. The sector provides the free flow of capital and liquidity in the marketplace. The economy grows if the sector is strong, similarly companies in this industry will be able to manage risk in a better way. The strength of the financial services sector leads to the prosperity of a country and population as well

The Financial Markets and Financial Institutions facilitate the functioning of the Financial System through Financial Instruments. The financial markets play a very significant role as far as the transfer of funds (financial assets) from surplus units to deficit units is concerned. This transfer of funds from lenders to borrowers is facilitated by banks and non-banking institutions, as well as various other agencies participating in the market. In addition to this we have already studied about the major participants in the Money Market and the Capital Market. etc in the first unit. In this unit we will be briefly discussing about the various aspects of the financial services and also the challenges this sector is posed with.

2.2 MEANING AND CONCEPT

The Financial Services Sector *per se* has become known in the past 25-30 years, although the concept of financial services has been in existence since times immemorial. However, there is no straight forward definition for the term Financial Services, but if we look at the meaning of the term ‘financial services’ as it is applied in UK, it could be understood to be including banking, insurance, stock broking and investment services as well as a wide range of other business and professional services. In other words, what we can say is that financial services are services that ensure the smooth flow of financial activities in the economy.

In short, it includes all activities involved in the transformation of savings into investment. Financial services refer to services provided by the finance industry. The finance industry consists of a broad range of organizations that deal with the management of money.

Financial services are an important component of the financial system. They cater to the needs of financial institutions, financial markets and financial instruments which are geared to serve individual and institutional investors. Financial institutions and financial markets facilitate functioning of the financial system through financial instruments. In order to fulfil the tasks assigned, they require a number of services of financial nature and hence financial services are regarded as the fourth element of the financial system. Thus, functioning of the financial system depends to a great deal on the range of financial services extended by the providers, and their efficiency and effectiveness.

Financial services not only help to raise the required funds but also ensure their efficient deployment. They assist in deciding the financing mix and extend their services up to the stage of servicing of lenders. In order to ensure an efficient management of funds, services such as bill discounting, factoring of debtors, parking of short-term funds in the money market, e-commerce and securitization of debts are provided by financial services firms. This sector provides services such as banking, insurance, credit rating, credit information, lease financing, factoring, venture capital, mutual funds, merchant banking, stock lending, depository services, housing finance, etc. These services are provided by various institutions like stock exchanges, specialized and general financial institutions, non-banking finance companies, subsidiaries of financial institutions, banks and insurance companies. Financial services sector is regulated by the Securities and Exchange Board of India (SEBI), IRDAI, Reserve Bank of India and the Department of Banking and Insurance, Government of India, through a plethora of legislations.

2.3 CHARACTERISTICS OF FINANCIAL SERVICES

Financial services are quite distinct in nature from the other services. The services provided by the financial institutions have some typical characteristics that make these products quite distinct from the products turned out by the industrial enterprises. Some of the basic characteristics of financial services are as stated below

i) **Information based**: Financial services industry is an information based industry. It involves creation, dissemination and use of information. Information is an essential component in the production of financial services.

ii) **Customer-Specific:** Financial services are usually customer focused. In order to cater a variety of financial and related needs of different customers in different areas, financial service organisations have to offer a wide range of products and services. The service institutions providing these services, study the needs of their customers in detail before deciding their financial strategy, giving due regard to costs, liquidity and maturity considerations. The providers of financial services constantly carry out market surveys, so that they can offer new products. Newer technologies are being used to introduce innovative, customer friendly products and services which clearly indicates that the providers of financial services concentrate on customer specific services.

iii) **Intangibility:** Financial services are intangible. Therefore, they cannot be standardized or reproduced in the same form. The institutions supplying the financial services should have a better image and confidence of the customers. Otherwise, they may not succeed. They have to focus on quality and innovation of their services. Then only they can build credibility and gain the trust of the customers.

iv) **Perishability**: Like other services, financial services also require a match between demand and supply. Services cannot be stored. Hence financial institutions have to ensure a proper synchronization of demand and supply.

v) **People based services:** Marketing of financial services has to be people intensive and hence it is subjected to variability of performance or quality of service. It requires competent and skilled personnel to market the quality financial products. The personnel in financial services organisation need to be selected on the basis of their suitability and trained properly, so that they can perform their activities efficiently and effectively.

2.4 EVOLUTION OF FINANCIAL SERVICES IN INDIA

The financial services industry in India is in the process of attaining full bloom. To reach the present position, it has passed through a number of stages as mentioned below:

The Stages of development

The story of the post-independent Indian financial sector can be summarized in three distinct phases—the first phase spanning over the 1950s and 1960s which was associated with underdeveloped banking; the second phase covering the 1970s and 1980s which laid the foundation of financial development across the country and the third phase since the 1990s which has been characterized by gradual and calibrated financial deepening and liberalization.

Indian Financial Sector: the journey from 1950 onwards

The Reserve Bank of India (RBI) was founded in 1935 under the Reserve Bank of India Act. The decade of 1950s and 1960s was characterized by limited access to finance of the productive sector and a large number of banking failures, which prompted the Govt., to nationalize fourteen private sector banks on 20 July 1969; and later six more commercial banks in 1980. Besides the commercial banks, there were four other types of financial institutions in the Indian financial sector:

Development Finance Institutions (DFIs), co-operative banks, regional rural banks and post-offices. The decade also saw the absence of effective capital markets. The gap was filled by establishing DFIs. The sources of funds of these DFIs were diverse but raised primarily from the domestic bond market, from multilateral institutions like the World Bank, refinance window of the RBI, and government budgetary provisions.

The Bombay Stock Exchange, the first stock exchange in India, was founded in 1875. Similar story was with insurance sector the life insurance business was nationalized in 1956 and the Life Insurance Corporation of India (LIC), was established. Until 1990 LIC had the monopoly in insurance business. In the year 1990 life insurance business was opened to the private sector. The general insurance business was nationalized later in 1972 when 107 insurance companies were amalgamated and grouped into just four government owned companies.

Reforms in the Indian financial sector Banking

The Report of the Committee on Financial System (Reserve Bank of India, 1991) and the Report of the Committee on Banking Sector Reforms (Government of India, 1998), both chaired by former Governor of the RBI, M Narasimham laid the foundation for reforms in the banking sector. In order to introduce competition, enhance efficiency and bring innovation in the banking sector'. Licenses were issued to new private sector commercial banks in the mid-1990s.To strengthen this sector various initiatives were taken such as, Setting up of the Indian Financial Network (INFINET) as the communication backbone for the financial sector, introduction of a Real Time Gross Settlement System (RTGS) and core banking solutions across banks encompassing most of their branches across India. The money market is a key component of the banking sector and monetary policy in India. Over the years, the money market has become deep and diverse with emergence of several segments like CBLO (collateralized borrowing and lending obligations) An important institutional reform was the establishment of the Clearing Corporation of India Limited (CCIL) as a central counterparty to provide guaranteed clearing and settlement functions for transactions in money, G-Secs, foreign exchange and derivative markets. Two new major types of small and differentiated banks—payments banks and small finance banks - have also emerged as the newest entrants in the Indian financial sector.

Merchant Banking

Merchant Banking Services were unknown until early 1960s. In India, merchant Banking firms were first introduced in the year 1967 by the Grind lays bank. The policy makers and researchers had lack of clarity about the term "merchant bankers". Someone defined them as institutions which were acting; neither as merchants nor as bankers. However the term was used as an umbrella function, providing a wide range of services, starting from project appraisal to arranging funds from bankers. Briefly stated the merchant bankers offer services such as

a) **Project Counselling:** Starting from the initial phase, i.e. preparing an application to obtaining sponsors

b) **Issue Management** -Another service offered by merchant banks is marketing corporate securities such as corporate shares or bonds by giving them to the public. In addition to this, the pricing is also decided by Merchant bankers.

c) **Underwriting of the public issue:** In this, an underwriter guarantees that in case an under subscription occurs, all the liabilities would be borne by the underwriter.

d) **Managing debt and equity offerings:** It is one of the main services offered by a merchant bank. The service includes assisting businesses in obtaining funding from the market.

e) **Managing portfolio:** Under this service, the securities are maintained efficiently. This ensures good returns are obtained from them along with reduced risks.

f) **Loan syndication:** Merchant bankers help their clients to raise syndicated loans from various financial institutions like banks.

g) **Financial advisory services and corporate counselling:** Merchant banking firms assist in taking care of corporation's finances. In addition to it, corporate counselling services are given to help businesses thrive.

h) **Corporate restructuring/reorganisation techniques:** When one company takes over the other, a merchant bank acts as a mediator in the companies' negotiation process. A fee is charged for the merchant banks' service, ensuring that it takes place without any hassle.

The Insurance Sector

The insurance industry is the backbone of country's Risk Management. The beginning of the Indian insurance industry dates back to the nineteenth century. In 1818, Europeans started Oriental Life Insurance Company in Kolkata (Calcutta) to exclusively serve their community. Evolution of insurance industry has undergone three phases, Pre-Nationalisation, Nationalisation and Privatisation. The Insurance industry was nationalised only after passing Life Insurance Corporation Act of 1956. There were more than two hundred insurance companies of both Indian and European origin. Former RBI Governor, R. N. Malhotra, initiated the reforms process in the Indian insurances sector in 1993. The Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body in 1999 and incorporated as astatutory body in April 2000.This paved the way for entry of private players in the insurance sector. The privatization helped to increase efficiency of insurance business. Many new private companies came up with attractive products. Some of the major private players in the Indian market are ICICI Prudential, Bajaj Allainz Life Insurance, Tata AIG life, Kotak Life Insurance, HDFC Standard Life, Reliance Life, ICICI Lombard etc.

Capital Market

Indian capital markets have a history of more than a century. The infrastructure for the capital market was strengthened through the establishment of a network of development financial institutions such as IFCI (1948), ICICI(1955), IDBI & UTI (1964),SFCs(during the fifties and sixties) and SIDCs (during the sixties and early seventies) However, they remained largely inactive till the 1970s. Partial liberalisation of the economy and pro-capital market policies during the 1980s infused some life into the markets, but it was only the economic liberalisation of the 1990s that provided a lasting impetus. The Indian capital market was not properly developed before Independence. The growth of the industrial securities market was very much hampered since there were very few companies and the number of securities traded in the stock exchanges was still smaller. A large part of the capital market consisted of the gilt-edged marker for government and semi-government securities. 1980s emerged an explosive growth of the securities market in India, with millions of investor suddenly discovering lucrative opportunities. Many investors came into the stock market.

Since 1992 the Indian capital market has been experiencing a process of structural transformation, puts its operational standard equivalent to developed markets The institutionalization process was strengthened by participation of FIIs which were permitted to invest in Indian capital market in September 1992. From then till date the investment by the FIIs has become a crucial factor in the movement of stock prices in India. Investment by the FIIs in Indian capital market not only affect share prices directly but also have an impact on stock market behaviour mainly, though effects on interest rates and asset prices. The recent market conditions are the outcome of role played by FIIs.

Bond / Debt Market

Traditionally the bond market is differentiated on the basis of ownership viz., government bonds and corporate bonds. Creation of primary dealers (PDs) to function as market makers (both in primary and secondary markets) in government bond market since 1995 is a major development in this sector

Mutual Funds (MFs)

The MFs have played a very important role in the Indian capital market. The UTI is the first mutual fund to be set up in 1964 under an Act. During 1987, the banks and financial institutions were allowed to set up mutual funds as subsidiaries. The private sector was allowed the entry into mutual funds industry since 1992-93. During the period 1963–1988, the Unit Trust of India (UTI) enjoyed the monopoly in the MF industry. The reform process of the MF industry started in 1988 when non-UTI, public sector mutual funds were set up by public sector banks, the LIC and the GIC entered the market. Subsequently, private sector funds were allowed to enter the MF industry in 1993. As of now (February 2022), 45 Asset Management Companies are registered with SEBI,

Non-Banking Finance Companies (NBFCs)

Apart from the banks, India has a number of non-banking financial companies(NBFCs). Although NBFCs have existed for a long time in India, these entities experienced sudden spurt in their activities between the late

1980s and the mid-1990s. The fundamental difference between banks and NBFCs in India are three: (a)NBFCs cannot accept demand deposits; (b) NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself; and (c) deposit insurance facility is not available to depositors of NBFCs, unlike in case of banks.

Credit rating service

The Credit Rating Information Services of India Limited (CRISIL) initiated the concept of credit rating in India. The CRISIL was established in 1987 and started operations in January 1988. Currently, rating agencies are engaged in, rating bonds, time deposits, CP and structured obligations. Ratings are meant to provide capital market participants with a single framework for comparing "credit quality". As at end February 2022, there are seven credit rating agencies in India including CRISIL, ICRA, CARE, India Ratings and Research Pvt Ltd**,** Acuite Ratings & Research (earlier SMERA Ratings Limited)**.,** Brickwork Ratings India Pvt. Ltd. and Infometrics Valuation and Rating Pvt. Ltd**..** which are authorised by SEBI to assess credit ratings.

2.5 NEW FINANCIAL INSTRUMENTS

The new financial instruments are both being talked about and are also being used. A new financial instrument may be one which has some new features in the terms of agreement, when compared with the features of presently available instruments. Financial innovation refers to the process of creating new financial or investment products, services, or processes. These changes can include updated technology, risk management, risk transfer, credit and equity generation, as well as many other innovations. The earlier way of getting finance from financial institutions has changed. Of late companies prefer the capital market route as a source of finance. With this end in view, financial institutions are compelled to offer attractive terms even on debt securities, in order to raise funds.

Both the market players and the regulators have for very long been engaged in the idea of setting up the derivatives market in India. When the Indian economy is trying to become global in nature, the fluctuations in the rate of foreign exchange would be a routine matter, and hence there would be a need for currency, interest, and commodity-based derivatives. Derivatives have now become increasingly important in the field of finance. Futures and options are now traded on many exchanges. Derivative instruments such as Forward Contracts, Swaps and many others are regularly traded both in the exchanges and in the over the counter market. By way of example a few new financial instruments are mentioned here.

a) **Floating Rate Bonds**- The interest rate on these bonds is linked to a benchmark/anchor rate and is not fixed

b) **Zero Interest Secured Premium Convertible Bond**- The investor can convert his bond into an equity share at 30 per cent discount on average price at the end of one year

c) **Auction Rated Debentures (ARDs)-** It is a secured, redeemable (after 90 days), non-convertible instrument with interest determined by the market and placed privately with bids.

d) **Secured Premium Notes (SPNs) with Detachable Warrants**-This instrument is redeemable after a notified period, of say four to seven years. There is a lock-in period during which no interest is paid.

e) **Non-convertible Debentures (NCDs) with Detachable Equity Warrants**-The holder of this instrument is given an option to buy a specific number of shares from the company at a pre- determined price and time frame

f) **Inverse Float Bonds**-These bonds are the latest entrants in the Indian capital market. Inverse float bonds are bonds carrying a floating rate of interest that is inversely related to short-term interest rates.

2.6 SIGNIFICANCE OF FINANCIAL SERVICES

The financial services sector plays a very crucial and significant role in a country's economy.

Growth and Development

The services now represent a significant proportion of the total economic activity in most economies. The financial institutions such as banks, insurance companies, trusts, loan companies, etc. play a vital role which act as financial intermediaries. In most developed economies, the financial services sector has grown rapidly over the post-war period. In India, this sector has come up gradually after independence. However, after the liberalization process initiated by the government, this sector saw a considerable growth. When one examines the structure of most economies over the last few decades, the most striking feature is the growth of the services sector as compared to the manufacturing sector. The RBI and Govt. of India have taken various initiatives which have helped the financial sector to show improved performance. The position as well as the initiatives taken by the Govt. are stated briefly below

The country's financial services sector consists of capital markets, insurance sector and banks and non-banking financial companies (NBFCs). India's gross national savings (GDS) as a percentage of Gross Domestic Product (GDP) stood at 30.50% in 2019. In 2019, US$ 2.5 billion was raised across 17 initial public offerings (IPOs). The number of ultra-high net-worth individuals (UHNWIs), with wealth of US$ 30 million or more, is expected to rise 63% between 2020 and 2025 to 11,198; India has the second-fastest growth in the world. India is expected to have 6.11 lakh HNWIs in 2025.

As per Economic Survey 2020- 21, following a contraction of 7.3% in 2020-21, the Indian economy is expected to grow by 9.2% in real terms in 2021-22 (according to initial advanced projections) GDP is expected to grow in real terms by 8-8.5% in 2022-23.

As of August 2021, Assets under Management (AUM) managed by the mutual funds industry stood at Rs. 36.59 trillion (US$ 492.77 billion) and the total number of accounts stood at 108.5 million. In May 2021, the mutual fund industry crossed over 10 crore folios. The Government of India has taken various steps to deepen reforms in the capital market, including simplification of the IPO process, which allows qualified foreign investors (QFIs) to access the Indian bond market. In 2019, investment in Indian equities by foreign portfolio investors (FPIs) touched five-year high of Rs. 101,122 crore (US$ 14.47 billion).

Government of India has recently enacted The Factoring Regulation (Amendment) Act, 2021 (Applicable w.e.f. 23.08.2021), which widens the scope of companies that can undertake factoring business. Under the provisions of the regulations mentioned above, all existing non-deposit taking NBFC-Investment and Credit Companies (NBFC-ICCs) with asset size of Rs.1,000 crore & above will be permitted to undertake factoring business subject to satisfaction of certain conditions. This will increase the number of NBFCs eligible to undertake factoring business significantly from 7 to 182

In July 2021, India's largest Commodities Derivatives Exchange, Multi Commodity Exchange of India Ltd., and European Energy Exchange AG (EEX) signed a memorandum of understanding (MOU) with the goal of knowledge sharing and expertise exchange on electricity derivative products. This MoU will make it easier for the two exchanges to collaborate in areas including knowledge sharing, education and training, and event planning in the field of electricity derivatives.

In January 2021, the National Stock Exchange (NSE) launched derivates on the Nifty Financial Service Index. This service index is likely to provide institutions and retail investors more flexibility to manage their finances.

Role of Financial Intermediation

Financial intermediaries work in the savings/investment cycle of an economy by serving as conduits to finance between the borrowers and the lenders. The financial services sector is made up of financial institutions such as banks, insurance companies, trusts, loan companies, credit unions, securities dealers and exchanges, etc. which act as financial intermediaries. Financial institutions carry out the process of financial intermediations by acting as a channel through which the financial surpluses of some groups in society (e.g. households) are collected and then distributed to other groups in society (e.g. firms) which have a deficit. It is well known that banks perform the role of taking in deposits from customers and lending it to other customers. Similarly, the insurance companies, particularly those involved in long-term life assurance business, collect premiums from policy holders and invest these surpluses in industrial/commercial activity *via* the stock market.

The growing size of the financial activity relative to the overall economic activity in a closely integrated world has implied that disruptions in the financial markets in any economy can engender contagion which can spread rapidly and have adverse economic ramifications. So the financial intermediations role played by the financial services sector is crucially important in moblising savings for investment purposes.

Unique Features

Financial services are unique in themselves but they do share many of the features of the products of other services. Financial services are intangible and perishable in nature. The institution providing these services may succeed only if they have a good image and confidence of the clients, and at the same time ensuring that demand &supply go hand-in-hand. The focus of these institutions has to be continuously on the quality and innovativeness of their services in order to gain the trust of their clients thereby building their credibility. The products of the financial services sector are usually long-term in nature and hence there is a great deal of uncertainty in the mind of the customer as to whether, he had made a right choice. Owing to the nature of these products, the consumer needs to seek external advice. However, much of this advice comes from the institution itself, mostly through their agents.

They usually provide advice on product suitability, quality and price either directly or via an agent/broker who is paid commission by the sellers of the services. The functions of producing and supplying financial services have to be performed simultaneously for which there has to be a perfect understanding between the financial services firms and their clients. Even the marketing of these services, needs to have, not only people-orientation, but also process-orientation. Financial services are usually customer-oriented. Financial services institutions study the needs of the customers in detail to suggest financial strategies which give due regard to costs, liquidity and maturity considerations. The providers of financial services remain inconstant touch with the market offering new products much ahead of need and impending legislation. Financial services have to be constantly redefined and refined on the basis of socio-economic changes such as disposable income, standard of living and educational changes related to the various classes of customers. Financial services institutions while evolving new services could be proactive in visualizing in advance what the markets want, or reactive to the needs and wants of customers.

Creation of Credit

The financial services sector particularly the banking sector is very important to the operation of the economy and to the conduct of the government economic policy. The major liability of banks is the customer's deposit, which is a significant element of the country's money supply. It is through their lending activities, that banks are able to create new bank deposits and hence the country's money supply.

Let us understand what this means with the help of a simple example. The assumption that we are making here is that cash advances are always repaid in the banking system as fresh deposits. Suppose Mr. X, who is a customer of a bank, deposits Rs. 1000 with the bank. The bank in turn lends Rs. 500 by way of cash advance to customer Y. The customer Y spends this cash, i.e. Rs. 500, with customer Z, who in turn deposits it with the banking system. Further, suppose that the bank lends you Rs. 1000 by making a loan, and crediting your current account. You, in turn, write a cheque on your account in favour of IGNOU, who deposits the cheque in its account. However, the net effect of lending is that there is no change on the overall banking system balance sheet, but the banking system now owes IGNOU Rs. 1000 rather than you. From this example, it could be seen that the banking system has thus increased its deposits and hence the money supply to 25% of its initial deposit. This process of deposit creation continues indefinitely, but in practice, the bank needs to retain a reasonable percentage of its deposits in cash or liquid assets. We may not go into these details here, but the point that needs to be emphasized upon is that the banks through their lending activities are able to create new bank deposits and hence increase the country's money supply.

Activity 2.1

1) Try to define financial services in your own words.

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2) Name few of the financial services that you have been using.

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2.7 TYPES OF FINANCIAL SERVICES

Although there is no such scheme of classification of financial services which may satisfy everyone or is able to cover all the subtleties of this industry. However, in order to understand the functioning of the financial services industry in a better perspective we have tried to organize our discussion of the financial services industry by classifying the financial services under three broad categories, i.e. Fee Based Services, Fund Based Services and

Insurance Services. Which are as follows:

Fee Based Services/Non fund based

Fee based financial services are those services wherein financial institutions operate in specialized fields to earn a substantial income by way of fees, dividend, commission, discount and brokerage on operations. This would help the institutions to increase their revenue while optimizing the use of funds and would help to spread their risk over variety of activities. The major activities are as follow:

a) Issue Management

b) Corporate Advisory Services

c) Credit Rating

d) Mutual Funds

e) Asset Securitisation

a) ***Issue Management***

Issue management refers to management of securities offerings of the corporate sector to public and existing shareholders on right basis. In simple words Issue Management refers to managing issues of corporate securities like equity shares, preference shares and debentures or bonds. Issue Managers in capital market parlance are known as Merchant Bankers or Lead Managers, although the term Merchant Banking covers a wide range of services such as project counselling, portfolio management, investment counselling, mergers and acquisitions, etc. Issue Management constitutes perhaps the most important and sizeable function within it, so much so, that very often the terms Merchant Banking and Issue Management are almost used synonymously. Issue management involves marketing of capital issues, of existing companies including rights issues and dilution of shares by letter of offer, merchant bankers give advice on decisions concerning size and timing of the public issue in the light of the market conditions. They also provide assistance to the corporate units on the designing of a sound structure acceptable to the financial institutions and determining the quantum and terms of the public issues of different forms of securities. Merchant Bankers also advise the issuing company whether to go for a fresh issue, additional issue, bonus issue, right issue or a combination of these. The various aspects of issue management are dealt with in detail, in unit "Issue Management "of this course.

b) ***Corporate Advisory Services***

Corporate Advisory Services are needed to ensure that a corporate enterprise runs efficiently at its maximum potential through effective management of financial and other resources. The services which come in the ambit of corporate advisory services, for a business enterprise, include services such as providing guidance in areas of diversification based on the Government's economic and licensing policies, appraising product lines and analyzing their growth and profitability, consultancy for rehabilitation of sick industrial units, advice on capital structuring and restructuring, etc. These services are usually provided by merchant bankers. Corporate advisory services constitute an important component of the portfolio of the activities of merchant bankers. It covers any matter worth the benefit for a corporate unit involving financial aspects, governmental regulations, policy changes and business environmental reshuffles, etc. Thus, the scope of the corporate advisory services is very vast ranging from managerial economics, investment and financial management to corporate laws and the related legal aspects. We have discussed at length most of the corporate advisory services in unit "Corporate Advisory Services" of this course.

c) ***Credit Rating***

Credit is the trust in a person's ability and intention to pay or reputation of solvency and honesty and rating means estimating the worth of or assigning the value to classify a person's position. Thus credit rating is an expression of an opinion through symbols about credit quality of the issue of securities or company with reference to a particular instrument.

The origin of this service lies in the financial crisis of the US in 1837. The first mercantile credit rating agency was set up in New York in 1841 to rate the ability of the merchants to pay financial obligations. In India, credit rating came in much later. The first credit rating agency viz. the Credit Rating and Information Services of India Ltd. (CRISIL) was set up in 1987, followed by ICRA in 1994.All the credit rating agencies in India are regulated by SEBI (Credit Rating Agencies Regulations, 1999) of the Securities and Exchange Board of India Act, 1992. There are a total of seven credit agencies in India viz, CRISIL, CARE, ICRA, SMREA, Brickwork Rating, India Rating and Research Pvt. Ltd and Informatics Valuation and Rating Private Limited.

In India, the scope of credit rating is limited to debt instruments, i.e. debentures, bonds, fixed deposits, commercial paper, etc. However, in developed countries equity shares are also rated. Credit rating is thus an important device in the hands of investors to analyse the instruments floated by issuers. To know more about the typology of credit rating, the credit rating process, and other related issues please refer unit "Credit Rating" of this course.

d) **Mutual Funds**

Mutual fund is a trust that pools the savings of a number of investors who share a common goal. Thus, it offers a common man an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost. In other words, mutual funds invest the money collected from the investors, with the help of professional managers, in capital market instruments, such as shares, debenture and other securities. This corpus of funds is managed by an investment professional known as a fund manager or portfolio manager. It is his/her job to invest the corpus in different securities such as bonds, stocks, gold and other assets and seek to provide potential returns. The gains (or losses) on the investment are shared collectively by the investors in proportion to their contribution to the fund. Mutual fund is usually a long-term investment with a certain level of risk. Of course, the open-ended feature of mutual funds ensures that you get money whenever you want at a short notice, i.e., the scheme on behalf of the unit holders invests in securities, collects the interest payments and dividends from these securities and sell them when you need money. At the time of initial public issue investors can invest in close-ended funds, but afterwards they can either buy or sell the units of the scheme on the stock exchanges where they are listed. In some schemes there is an option of selling back the units to the mutual fund through periodic repurchase at NAV related prices. As per SEBI Regulations at least one of the two exit routes is to be provided to the investor. The tax-saving Equity Linked Saving Schemes (ELSS) and pension schemes give added benefit of tax rebate. For more details on the topic please refer unit "Mutual Funds" of this course.

e) **Asset Securitisation**

Asset Securitisation is a process whereby loans and other receivables are packaged, underwritten and sold in the form of asset-backed securities. Securitisation involves transactions where credit risk in assets are redistributed by repackaging them into tradeable securities with different risk profiles which may give investors of various classes access to exposures which they otherwise might be unable to access directly. The assets which can be securitised include receivables from the government, trade related receivables, credit card receivables, automobile loans, real estate loans, housing loans etc. Securitisation can be defined as the process which takes place when a lending institution's assets are removed in one way or the other from the balance sheet of that lending institution and are funded instead by investors who purchase a negotiable instrument evidencing this indebtedness without recourse or with limited recourse to the original lender. Under Asset Securitisation a financial institution pools and packages individual loans and receivables, creates securities against them, gets them rated and sells them to the investors at large through public offerings or private placements (Trustee). The asset cash flow is remitted to the trustee who in turn pays scheduled interest and principal payment to the investors. Thus, " Securitisation is a synthetic technique of converting assets into securities, securities into liquidity, liquidity into assets and assets into securities on an ongoing basis" thereby providing flexibility of yield, pricing pattern, size risks and marketability of instruments used to the advantage of both borrowers and lenders/investors. You may refer to "Asset Securitisation" unit to know about the origin, process, mechanism and instruments of securitisation.

Banks offer certain non-fund based products to its clients as follows:

- **Letter of Credit:** Banks offer import as well as domestic letter of credit facility to clients for procurement of goods on, documents against acceptance (DA)/documents against payment (DP) basis as per their needs at very competitive rates.

- **Bank Guarantee:** bank guarantee facility is offered to clients guaranteeing their performance/financial obligations in the domestic as well as international market.
- **LC Advising/Confirming Services:** In case of letters of credit received by clients, banks offer LC advising as well as LC confirmation services under correspondent relationships with domestic as well as international banks.
- **Co-acceptance facilities:** Sometimes business deals on credit basis, buyers are required to offer adequate comforts to the sellers such as bank guarantee or co-acceptance of bills by the bankers. Banks offer co-acceptance of bills facility to the top rated clients.
- **Solvency Certificate:** Banks provide solvency certificate to their clients in case it is required for providing to government authorities, other corporates in business deals, bids, etc.

Fund Based Services

In fund-based services the firm raises funds through equity, debt, and deposits and invests these funds in securities or lends to those who are in need of capital. We will be discussing here some of these fund-based services such as:

a) Leasing and Hire Purchase
b) Housing Finance
c) Credit Cards
d) Venture Capital
e) Factoring
f) Forfaiting
g) Bill Discounting

a) ***Leasing and Hire Purchase***

The growth of leasing industry can be traced to the formation of First Leasing company of India in 1973 by Mr. Farouk Irani and remained the only company in the country till 1980. By 1981, a few more companies, i.e. 20th Century Finance Corporation, Shetty Investment and Finance, Jay bharat Credit and Investment, Sundaram Finance, etc. joined the leasing game. During the late 1982, numerous financial institutions and commercial banks started joining in. Since then the industry has prospered and today we find it as a flourishing business.

Leasing is a process by which a firm can obtain the use of a certain fixed assets for which it must pay a series of contractual, periodic, tax deductible payments. The lessee is the receiver of the services or the assets under the lease contract and the lessor is the owner of the assets. The relationship between the tenant and the land lord is called a tenancy, and can be for a fixed or an indefinite period of time (called the term of the lease). The consideration for the lease is called rent. However, the lessee is responsible for the maintenance of the asset. In leasing the cost of capital is usually recovered from multiple serial rentals and the final sale of the asset. All financial leases virtually fall under one of the four types of lease financing viz. capital lease, operating lease, sale and lease back and leveraged lease which are explained in detail in the unit "Leasing and Hire Purchase"

Hire purchase is a method of financing of the fixed asset to be purchased on future date. Under this method of financing, the purchase price is paid in instalments. Ownership of the asset is transferred after the payment of the last instalment. Under this type of financing Every instalment is treated as hire charge for using the asset. The hire vendor has the right to repossess the asset in case of difficulties in obtaining the payment of instalment. There are many advantages to the hire purchaser such as i) Hire purchaser gets the benefit of depreciation on asset hired by him/her. ii) Hire purchasers also enjoy the tax benefit on the interest payable by them and iii) Hire purchaser becomes the owner of the asset in future

b) ***Housing Finance***

Housing Finance means financing, for purchase/ construction/ reconstruction/ renovation/ repairs of residential dwelling units, which includes: Loans to individuals or group of individuals including co-operative societies for construction/ purchase of new dwelling units.

Housing is one of the basic needs of the society. It is closely linked with the process of overall socio-economic development of a country. This sector remained neglected for quite some time. The housing finance sector has traditionally been largely driven by banks or a handful of housing finance companies. The scenario is fast changing. With the growing number of housing finance companies, the challenge is not just to render financial inclusion, but to create a conducive environment for them to sustain and scale up. Presently, funds required per dwelling shelter are so high that the individual's saving is not adequate to meet the expenditure of house building. As a result, there is a great demand for external housing finance. To take advantage of this situation, the lending institutions are competing with each other for a market share by offering very attractive terms to the customers in the form of lower rate of interest, liberal collateral requirements, longer payment period etc. These institutions have also introduced the floating rate products besides the fixed rate ones, with the option made available to the borrower for conversion against a nominal payment. The other tactics of market acquisition are speedier processing and disbursement, efficient advisory services, waiver or reductions in associated upfront fees etc. In housing finance unit, we have explained the role of National Housing Bank in housing finance. We have also discussed therein the housing finance schemes offered by various housing finance institutions. For further details please refer to unit "Housing Finance" of this course.

c) *Credit Cards*

Credit cards generally known as plastic money, is widely used by consumers all-around the world. The convenience and safety factors add value to these cards. The changes in the consumer behaviour led to the growth of credit cards. A credit card is a payment card issued to users (cardholders) to enable the cardholder to pay a merchant for goods and services based on the cardholder's accrued debt. The primary criteria for issue of a credit card is applicant's credit score and income.

The card issuer also enters into a tie-up with merchant establishments which are engaged in various fields of business activities. The issuer for its convenience and for proper scrutiny sets up a credit limit for its card holders and a floor limit for its merchant establishments. The credit card offers the individual an opportunity to buy rail/air tickets, makes purchases from shops and stay at hotels when they need.

Credit card is a card which enables an individual to purchase certain products/services without paying immediately. He needs to only present the credit card at the cash counter. In short he can make purchase against credit card without making immediate cash payment. Therefore, credit cards can be considered as a good substitute for cash and cheques. In order to know the details of this financial service, you may go through the unit on other services.

d) *Venture Capital*

The concept of Venture Capital was introduced in India by the all India Financial Institutions with the inauguration of Risk Capital Foundation (RCF) sponsored by the Industrial Finance Corporation of India (IFCI) to supplement promoter's equity, with a view to encourage technologists and professionals to promote new industries. Venture Capital is money invested in businesses that are small; or exist only as an initiative, but have huge potential to grow. The people who invest this money are called venture capitalists (VCs). The venture capital investment is made when a venture capitalist buys shares of such a company and becomes a financial partner in the business. Venture Capital investment is also referred to as risk capital as it includes the risk of losing the money if the venture doesn't succeed and takes medium to long term period for the investments to fructify. Venture Capital typically comes from institutional investors and high net worth individuals and is pooled together by dedicated investment firms. Software and other intellectual property are generally the most common cases whose value is unproven. That is why; Venture capital funding is most widespread in the fast-growing technology and biotechnology fields. This topic is discussed at length in venture capital unit.

e) ***Factoring***

The word factor is derived from the Latin word *facere*. It means to make or do or to get things done. Factoring service caters to the requirements of the Indian Industries in the changed business environment. Factoring is an arrangement between the financial institution or banks (factor) and the business concern (the supplier) which provides goods or services to its customers on credit, wherein the factor buys out clients (suppliers) book debts. There is always a difficulty of foreign languages, customs and laws, fear of distance, ocean barriers etc. which inhibit entrepreneurs from venturing into export business, consequently, affecting the country's export. Factoring is a service that relieves the exporters from the fear of credit losses enabling them to offer open account terms to overseas customers. Factoring simply refers to selling the receivables by a firm to another party. The buyer of the receivables is called the factor. Thus factoring refers to the agreement in which the receivables are sold by a firm (client) to the factor (financial intermediary). The factor can be a commercial bank or a finance company. When receivables are factored, the factor takes possession of the receivables and generally becomes responsible for its collection. It also undertakes administration of credit i.e. credit control, sales accounting etc. Thus factoring may be defined as selling the receivables of a firm at a discount to a financial organisation (factor). The cash from the sale of the receivables provides finance to the selling company (client). Out of the difference between the face value of the receivables and what the factor pays the selling company (i.e. discount), it meets its expenses (collection, accounting etc.). The balance is the profit of the factor for the factoring services

Factoring scenario in India

Factoring service in India is of recent origin. It owes its genesis to the recommendations of the Kalyanasundaram Study Group appointed by the RBI in 1989. Pursuant to the acceptance of these recommendations, the RBI issued guidelines for factoring services in 1990. The first factoring company – SBI Factors and Commercial Ltd (SBI FACS)started operation in April 1991.Banks are permitted to invest in factoring companies to a certain limit but they cannot act as promoters of such companies. Investment of a bank in the shares of factoring companies including its factoring subsidiary cannot exceed in the aggregate 10% of the paid-up capital and reserve of the bank. Banks are mandated to ensure that factoring services are provided only for genuine trade transactions. Banks are also required to ensure that the pre-payment amount offered for the receivables is not more than 80% of the invoice value. Under the Factoring Regulation Act, 2011, factoring companies other than banks, have to be registered with the Reserve Bank.

f) ***Forfaiting***

Forfaiting is a method of trade finance that allows exporters to obtain cash by selling their medium and long-term foreign accounts receivable at a discount to a forfaiter, a specialized finance firm or a department in a bank.

Forfaiting is a financial tool for exporters, enabling them to convert their 'credit sales' to 'cash sales' by discounting their receivables with an agency called forfeiter. Forfaiting denotes the purchase of trade bills or promissory notes by a bank or financial institution without recourse to seller. For exporters it is a 'Risk Management 'tool as well, because by selling the export receivables to the forfeiter the exporter is relieved of the inherent political and commercial risks involved in international trade. Thus, all risks and collection problems are fully the purchaser's (forfeiters') responsibility who pays cash to seller after discounting the notes or bills. It is backed by bank guarantee. In India, the Export Import Bank of India (EXIM Bank) facilitates this service with an overseas forfeiter agency for which they charge a commission.

g) ***Bill Discounting***

Bills of exchange that are used in the course of normal trade and commercial activities are called commercial bills. Bill Discounting is a short-term finance for business concerns wherein they can sell unpaid invoices, due on a future date, to financial institutions in lieu of a commission. The Bank purchases the bill (Promissory Note) before its due date and credits the bill's value after a discount charge to the customer's account. The bank will realise the bill amount on the bill's due date directly from the debtor. This helps the business concerns in optimising their cash flows and business (payment) cycles without disturbing their balance sheet. Lenders usually offer tenors of up to 180 days while offering bill discounting facilities. Bill discounting, just as factoring and forfaiting, is a short-term trade finance, also known as acceptance credit where one party accepts the liability of trade towards third party. For further details please refer to unit "Factoring, Forfaiting Bill Discounting and Asset Securitization" of this course

Insurance Services

Insurance, as we all know, is the most preferable method of handling risks and hence is also called as 'risk cover'. Risk is nothing but an uncertainty of occurrence of a loss viz. loss of lives, accidents causing permanent disability, loss of houses due to floods etc.

Insurance sector is quite large. It is growing at the rate of 15-20%.Together with banking sector this sector adds about 7% to the country's GDP. A well developed insurance sector is a boon for the economic development as it provides long term funds for infrastructure development and at the same time strengthening the risk taking ability of the country. The insurance sector has gone through a number of phases by allowing private companies to solicit insurance and also allowing foreign direct investment. India allowed private companies in insurance sector in 2000, setting a limit on FDI to 26%, which was increased to 49% in 2014, and further increased to 74% in May 2021. Since the privatisation in 2001, the largest life-insurance company in India, Life Insurance Corporation of India has held a monopoly till now but its market share slowly slipping to private giants like HDFC Life, ICICI Prudential Life Insurance, General Insurance Corporation of India and Exide Life Insurance.

Insurance is a contract between two parties – the insurer (the insurance company) and the insured (the person or entity seeking the cover) – wherein the insurer agrees to pay the insured for financial losses out of any unforeseen events in return for a regular payment of "premium". In insurance the actual loss is substituted by average loss by spreading the losses of unfortunate few over the entire group. This is a financial service wherein the insured is re-established to his or her approximate financial position prior to the occurrence of loss. Thus, insurance provides an unique sense of security that no other form of investment provides.

Insurance is an attractive investment option as well. These products yield more compared to regular investment options, and this is besides the added incentives offered by insurers. It serves as an excellent tax saving mechanism too. In case of life insurance , Employee's contribution under section 80CCD (1) Maximum deduction allowed under the I T Act is least of the following

- 10% of salary (in case taxpayer is employee)
- 20% of gross total income (in case of self employed)
- Rs 1.5 Lakh (limit allowed u/s 80C)

The insurance industry of India has 57 insurance companies 24 are in the life insurance business, while 34 are non-life insurers (as of Nov 2021). Among the life insurers, Life Insurance Corporation (LIC) is the sole public sector company. There are six public sector insurers in the non-life insurance segment. In addition to these, there is a sole national re-insurer, namely General Insurance Corporation of India (GIC Re). Other stakeholders in the Indian Insurance market include agents (individual and corporate), brokers, surveyors and third-party administrators servicing health insurance claims. The insurance regulator IRDAI has also undertaken various initiatives towards boosting the insurance penetration, such as permitting insurers to conduct video-based KYC, launching standardized insurance products and allowing insurers to offer rewards for low-risk behaviour.

The 'Insurance Regulatory and Development Authority' has extensive powers to oversee the insurance business and regulate it in a manner so as to safeguard the interest of the insured. To have a detail knowledge about "Life Insurance, Non life Insurance, Insurance Broking and various other aspects of insurance you can refer our course on 'Management of Insurance Services'.

Modern financial services

Modern financial services include innumerable activities like:

1) Rendering project advisory services.
2) Planning for mergers and acquisitions.
3) Guiding corporate customers in capital restructuring.
4) Acting as Trustees to Debenture holders.
5) Recommending suitable changes in financial structure.
6) Structuring the financial collaboration through joint ventures
7) Rehabilitating and reconstructing sick companies through reconstruction.
8) Hedging of risks through derivative trading.
9) Managing portfolio of public sector corporations.
10) Asset liability management.
11) Undertaking risk management services through insurance.
12) Advising clients for selecting the best source of funds.
13) Guiding clients for determining the optimum debt-equity mix.
14) Undertaking specialized services like credit rating, underwriting, registration and transfers, clearing services, custodian services etc.

Activity 2.2

i) Explain why financial institutions are keen to extend non fund based services

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ii) Write a note on any three fund based services extended by financial institutions.

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2.8 IMPACT OF TECHNOLOGY

The financial services industry both nationally and internationally is one of the most dynamic and rapidly growing sector of the economy. It is critically significant to health of the global economy as well as that of individual businesses and consumers. The overall percentage of employment in the financial services has increased. These developments are cited as a part of the 'information revolution'. The landscape of the financial sector has changed particularly after the global financial crisis mainly because of overall financial regulation and financial technology innovation. Some of the effects of the information technology on the financial services sector are given below.

From the Service Providers Point of View

Cost Saving

Information technology has contributed to the containment of the cost associated with the management of information and the execution of transactions. A single transaction costs around Rs.60 if conducted through a branch, but if done through ATM this cost comes to about Rs.21 (beyond free transactions permitted by the bank). The same transaction if conducted electronically through the internet, costs only Rs.4. Thus we can see that the cost incurred by the financial services firms can be reduced to a great extent by the efficient use of technology, thereby enhancing its profitability.

One of the major costs of the financial services firms is the labour-cost. The computerization of bank-branches has increased the efficiency of the functioning of the banks. The networking technology has helped the banks to introduce the single window system. It means that a single person is able to handle the work which was earlier being done by a number of persons. In other words, technology has reduced the labour requirements of financial services firms, drastically reducing the cost incurred by these firms on labour.

Product Development

The aim of product development is to meet consumer needs as well as increasing profit and business sustainability. Products are one dimension of competition in the financial services sector. The efforts in product development has to receive adequate attention because it is vital to improving the quality of services to promote customer adoption, consumer satisfaction, customer retention, profitability and long-term sustainability. In the financial services sector technological developments have been of great aid in enhancing the existing services, creating new services and also bringing about product differentiation. The traditional service of cash payment has been enhanced by providing an alternative i.e. digital payments. Some of these include the use of debit/credit cards, internet banking, mobile wallets, digital payment apps, Unified Payments Interface (UPI) service, Unstructured Supplementary Service Data (USSD), Bank prepaid cards, mobile banking, etc. Another product which has been developed and implemented is on-line and touch-screen share-dealing services which has simplified the procedures for buying and selling shares.

If observed closely, we find that most of the services provided by the financial services sector are not new services but rather they are the new ways of offering traditional services. For example, Internet banking can just be thought of as an alternative way of providing traditional account-based services to retail bank customers. Similarly, the Automated Teller Machines (ATMs) which most of you must be familiar with is simply an alternative way of obtaining cash or making payment. However, the use of computer, telecommunication and information technology and the drifting from conventional bank branch network is what makes these products new. Information technology has thus contributed to product differentiation to a great extent, in the financial services sector.

The advent of smart analytics allows financial services companies to mine the wealth of consumer data to understand and service customers better. Technology has also helped organizations develop innovative financial services

Marketing Tool

Marketing of financial services is to be people-intensive and therefore subject to variability of performance or quality of service. The data base technology enables the financial institution, especially banks to access the data collected in connection with one of its services to identify the potential customers for its other services.

To remain competitive, financial services organizations need to accept the fact that the customer base they serve is going through a major shift in terms of buying behaviors and preferences, much of which is being driven by the digital technology revolution, particularly social media and mobile. Generation Y, for example, wants more choice and control in how they interact with a bank or insurance company, whether it be self-directed, internet-led, person-to-person, on the phone or in an office. Technology is an enabler to service this growing and changing customers.

Most of the commercial banks, private banks, foreign banks, financial institutions etc. who are members of the Indian Financial Network (INFINET) a wide area satellite based network using VSAT technology, have a wider geographical coverage, enabling these banks in tapping new markets and also for providing value added services to the existing customers. Web gives the service providers an ability to serve tens of thousands of customers each day.

Delivery channel

Financial services companies are on the lookout for new technologies to improve efficiency and speed of service, as well as provide better customer experience. A cash withdrawal through an automated teller machine (ATM) is not substantively different from one taken through human teller. However, the availability of technologies has changed the process and now cash is available 24x7 even on holidays. In addition to this the ATMs provide other services such as balance enquiry, mini statement, fund transfer etc. Digitally-enabled financial services facilitate day-to-day living, help families and businesses plan for everything from long-term goals to unexpected emergencies, and contribute to their prosperity and resilience. Computers were devised with a focus mainly on advantage of time and place, to the customers.

Price Discovery in Govt. Securities

There has been a migration from a Screen based trading system for Government Securities to an Order Matching System so as to result in better price discovery and more transparency in the market related transactions in Government securities.

Decision-making Aid

Technology is an aid in the hands of decision makers and not a replacement for managers. Artificial intelligence systems such as the Expert systems are being used for making decisions of a repetitive nature. Since this system uses a common set of decision rules, the decision-making is more consistent across the organisation, unlike human decision makers. Business intelligence system provides data for historical, current and future trends. This data aids the banks in a way that they are able to take accurate decisions and thereby can bring an overall increase in the productivity, efficiency and profitability.

From Customers Point of View

Accessibility: The computer as well as developments in the information & communication technology has provided an easy access to information. The web helps the customers to access much better & complete information about various products and services being provided by different financial institutions. The customers find it easy to compare the services and rates of similar kind of services offered by different institutions and then take a decision accordingly. For example the information about the different cards and the services as well as charges that go along with it, offered by various banks can now be easily accessed. The coronavirus (COVID-19) pandemic had a significant impact on the digital transformation, creating a direct need for financial service providers to communicate with their customers through digital channels, such as platforms and apps, while social distancing was the norm. The number of digital users has increased considerably since the start of the pandemic.

Convenience: The customers are no longer required to go to the banks for withdrawal of cash or to procure any information related to his/her account. The Automated Teller Machines (ATMs) can be used by the customer to withdraw cash anytime, anywhere across the country. No one wants to spend time and money traveling to a bank branch and standing in line. The advent of net banking and mobile banking has reduced the time one spends for banking related tasks and has also ensured hassle-free customer service even from a remote location. It has now become convenient for customers to carry on trading online through their depository participants. Call Centres opened by financial institutions have enhanced the convenience of customers, wherein they can get assistance, as well as information, quickly and accurately. In other words, customers appreciate being able to access all their financial services online or via mobile devices.

Speedier Settlement of Transactions: The communication and information technology has no doubt increased the speed with which the transactions can now be made. It is now possible to settle bill payments electronically. The depositories do facilitate quick settlement of securities electronically. An internet enabled remittance facility has enabled domestic as well as international payment system much faster. The need for money orders, demand draft, traveller's cheques etc. are all things of past. People find it more convenient to transact through the payment apps any time of day and night without the need to approach banks for remittances. This service not only saves time but is also cheaper.

Less Errors and Better Data Protection: In the olden days when banking was completely dependent on the human accuracy and skill, mistakes and errors were more apparent. As human capabilities have a limit, they are prone to skip certain things or make calculation errors. With the introduction of computers, the frequency of errors has reduced to almost nil. Also, another important perspective to this, is that it can protect the data much more efficiently.

2.9 CHALLENGES BEFORE THE FINANCIAL SERVICES SECTOR

Financial service firms are facing many challenges today. Most of it has to do with the rapid changes in technology. While the vast majority of financial firms have embraced the technology revolution, there are still many challenges these companies have to face.

2.9.1 Cybercrime

Data breaches involving financial service firms are on the increase. Variety of techniques are used; cyber-attacks may be designed to steal money or information or disrupt an institution's operations, and attackers don't just focus on technological vulnerabilities. They also use social engineering techniques to trick people into divulging confidential information or providing attackers with access to the institution's systems. The key to combating cyber threats is to conduct a comprehensive risk assessment that identifies financial institution's potential access points and vulnerabilities, and quantify the potential cost of a breach.

2.9.2 Keeping Up with Regulations

Regulations in the financial service industry continue to increase. Banks are spending a large part of their income on making sure they're compliant. Any deviation results in fine from the Regulators. Therefore, they have to make sure there are systems to keep up with ever-changing regulations and industry standards. Traditional banks have to constantly evaluate and improve their operations to keep up with fast-changing consumer and shareholder expectations, technology, and industry regulations

2.9.3 Consumer Expectations

Consumers continue to expect a lot from their financial institutions. Many want more personalized services from their financial providers.

2.9.4 Competition

Competition within the financial services industry is still robust. As mentioned earlier, consumers want more personalized service. They also want more automated services with easier access to them. Present day, consumers are less concerned with brand loyalty and identity, what they expect is service with least cost and promptness Those institutions that provide service as per their expectations will be the winners garnering a big share in the market.

2.9.5 Keeping Up with Technology

Business growth is very important aspect for financial firms, to ensure growth they need to invest in updating their technology. Firms need to modernize their technology platforms and data storage to enable big data solutions such as artificial intelligence (AI) supported digital customer support assistants so that a more efficient, customer-friendly experience across internet, mobile and physical locations can be provided.

2.9.6 Digital Marketing Strategy

The effective use of digital channels to garner leads and customers are the important digital transformation challenges the financial industry faces toady. Many banks and financing companies are having difficulty being efficient, effective, and also in measuring the impact of their marketing channels. A well planned strategy is the need of the hour to remain competitive.

2.9.7 Organizational structure

The financial sector now operates in a more competitive environment than before. In an increasingly competitive environment between banks/insurance companies and other players of the financial system, it is necessary for these institutions to equip themselves with the structure. These firms need to properly revamp their organizational structure so that they are able to bear the stress and strains of growth, as well as, face the challenge arising from the rapidly changing scenario. The structure should be a judicious blending of the needs for greater delegation of power, decentralization of control and constant monitoring of performance. Designing of an appropriate organizational structure is a big challenge.

2.9.8 Training to Staff

The employees of the financial services sector (particularly those employed in the public sector banks and insurance companies) need to be trained for delivering better services to their customers. The training should include developing the appropriate mindsets to deal with different types of customers. Globalization of finance has already gained momentum with the technological advancements breaking national borders in the financial services sector. A greater number of international players would be entering the Indian financial system; the challenge before the financial institutions is to go global by searching new markets, customers and profits.

2.9.9 Innovation

The firm providing financial services need to come up with new products with better services in order to retain its old customers and attract new ones. However with the help of communication and networking technologies the utilization of the existing facilities could be improved to provide enhanced customer convenience and satisfaction. The major challenge before the financial institutions in India thus relates to the need to introduce innovative, customer friendly products and services for which newer technologies have to be brought in multiple areas to reduce the overall transaction costs.

Road Ahead

- India is expected to be the fourth largest private wealth market globally by 2028.
- India is today one of the most vibrant global economies on the back of robust banking and insurance sectors. The relaxation of foreign investment rules has received a positive response from the insurance sector, with many companies announcing plans to increase their stakes in joint ventures with Indian companies. Over the coming quarters, there could be a series of joint venture deals between global insurance giants and local players.
- The Association of Mutual Funds in India (AMFI) is targeting nearly five-fold growth in Assets under management (AUM) to Rs. 95 lakh crore (US$ 1.47 trillion) and more than three times growth in investor accounts to 130 million by 2025.
- India's mobile wallet industry is estimated to grow at a Compound Annual Growth Rate (CAGR) of 150% to reach US$ 4.4 billion by 2022, while mobile wallet transactions will touch Rs. 32 trillion (USD$ 492.6

billion) during the same period.

- According to Goldman Sachs, investors have been pouring money into India's stock market, which is likely to reach US$ 5 trillion, surpassing the UK, and become the fifth-largest stock market worldwide by 2024.

2.10 SUMMARY

We were late-starters in the field of Financial Services and almost lagged behind by about 100 years. It took quite a long time for us to think of the financial services institutions, the nature and quality of the services to be delivered by them, the latitude which could be given to them to float instruments, and the extent of regulation which could be exercised on their working by regulators. In the first stage of the development of financial services, our concentration was on the setting up and functioning of investment institutions, insurance business, leasing and merchant banking firms. In the second stage, our concentration shifted to hire purchase, factoring, venture capital funds, and reforms in the stock and capital markets. The third round of development has addressed itself to the questions of computerisation, paperless trading, setting up of depositories, innovation of new financial instruments, and integration of the financial services with the rest of the world by permitting the foreign financial institutions to have their foothold in India.

The financial services industry provides a great value addition, and is characterised by a high rate of growth which has turned out to be many times more than that achieved by agriculture and industry in India. Both the development of infrastructure and industry would require massive funds and the financial services industry would play a critical and decisive role in the development of infrastructure. However some of the factors inhibiting the growth of the financial services industry in India are lack of suitable and adequate personnel, exorbitant cost of office space and slower adoption of technology in its various operations. In this unit we have briefly discussed the various types of Financial Services provided by the Financial Institutions. The Indian financial system has undergone structural transformation over the past decade. The financial sector has acquired strength, efficiency and stability by the combined effect of competition, regulatory measures, and policy environment. Competition, consolidation and convergence have been recognized as the key drivers in the coming years. These services will be dealt with in detail in the subsequent units.

2.11 KEY WORDS

Financial Services : are services rendered by finanancial institutions, facilitating the smooth flow of financial activities in the economy of the financial system

Fee Based Services : Financial services firms that enable the corporate sector and other to raise capital from the market and manage or transfer their risk to other participants of the market are in fee based services.

Fund Based Services : Financial services firms that cater the short-term term needs of funds of corporate sector and others are in the funds-based services.

Insurance : It is a contract between two parties, the insurer and the insured - wherein the insurer agrees to pay the insured for the financial losses arising out of any unforeseen events in return for a regular payment of 'premium'.

2.12 SELF ASSESSMENT QUESTIONS

1) Explain the terms financial services, and discuss the characteristics of financial services.
2) Discuss the significance of the financial services sector in detail.
3) Describe the various fee based services being provided by the financial institutions
4) Explain the fund based services that are provided by the financial institutions.
5) Discuss the impact that technology has made on the financial service sector.
6) Discuss the challenges that the banking industry is confronted with.

2.13 FURTHER READINGS

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UNIT 3 REGULATORY FRAMEWORK

Objectives

The main objectives of this unit are to:

- provide a general framework of the Regulations governing the financial services industry;
- explain different types of Regulation; and
- explain regulations that are in force for the banking, insurance and other financial services.

Structure

3.1 INTRODUCTION

At the centre of any economy, it is the process of financial intermediation and disintermediation that helps the economy to grow and function smoothly. For instance, the credit creation function of banking institutions allows the economy to expand more than what it could do without banking institutions. Financial services industry not only channels savings into productive investments, it also helps the economic activities to take place without much difficulties. For example, the cheque facility and clearing service and /or digital banking service provided by the banks help several million people to perform economic activities. Similarly, stock brokers help investors to sell and buy shares which is critical for development of financial services and financial markets. Insurance companies give protection against the risk of many unknown events like fire, flood etc., that affect the business and allow the firms to perform their activities with confidence. The financial services have thus become indispensable in running the economy. Such an important system faces two problems –cheating and instability. During the stock market scams, many investors were cheated. Recently, internet bubble attracted several investors, who lost their wealth. While such losses are partially on account of investors overvaluing the securities, it is also on account of many firms providing misleading information. Financial markets are also highly volatile and show instability in that process. In view of its importance in the economy, the need for strict regulatory machinery need not be emphasized. This sector is governed by well established regulators. Though regulations per se may not remove cheating and reduce volatility, it would certainly help to reduce its occurrence and minimise the length of volatile period.

A financial service cannot generally be tested at the time of purchase since there is a time-lag between the purchase of service and its actual effect. For example, when you buy a share through a member of stock exchange, the service completes only at the time of delivery of shares. Similarly, when you buy units of mutual fund and avail its expert service of investment, the results of this service is known only in the future. In case of dealings in cheques/on line payments, the service concludes only when the amount is credited or debited in your account but the time-lag is short. The need for regulation stems from the problems of failure of the firms which provide financial services and thus causing hardship to the purchaser. Since financial system is closely integrated and inter-linked, failure of one firm often affects other firms and thus the entire financial system is affected. Further, in a competitive market for borrowing and lending where the spread is thin, financial services firms often take high risk to maximize the return and thus are more susceptible to default. There are several other events that can imperil the interest of investors and others who avail the services. The list includes fraud, misfeasance and collapse of an institution due to mismanagement etc. Regulations are thus in place to safeguard the interests of the participants of the system and prevent economic instability. Regulatory bodies are interconnected with various industries, and a financial service is no exception. Independent agencies are designated to oversee different financial institutions' operations, uphold transparency, and ensure that clients are treated fairly. The second aspect assumes more relevance after several East-Asian economies had suffered due to the failure of the financial system.

3.2 TYPES OF REGULATIONS

The health of the financial sector is a matter of public policy concern in view of its critical contribution to economic performance. Financial regulation and supervision assumes importance in ensuring that the financial system operates along sound lines. The primary justification for financial regulation by authorities is to prevent systemic risk, avoid financial crises and protect depositors'/investor's interest and reduce asymmetry of information between depositors/investors and concerned institution. Besides, financial regulation attempts to enhance the efficiency of the financial system and to achieve a broad range of social objectives.

The financial system in India is regulated by independent regulatory bodies in different fields namely banking, capital market, insurance, commodity market, and pension funds. However, the Government of India plays an important role in influencing the regulatory framework of these institutions.

The different levels of regulation on financial services is explained below in the Table 3.1

Table 3.1: Different Levels of Regulation on Financial Services

Level I	**Government of India**
	Appellate Authority and Regulator in certain cases
Level II	**Legislation passed in the Parliament**
	Banking Regulation Act, SCRA, Insurance Act Indian Trust Act, etc.
Level III	**Institutions under an Act of Parliament**
	UTI Act, LIC Act, GIC Act, etc.
Level IV	**Regulators**
	RBI, SEBI, IRA, Forward Market Commission
Level V	**Regulations given by the Regulators**
	RBI Directions to Commercial Banks, NBFCs Directions issued by the RBI, SEBI Regulations, Guidelines, Notification, etc.
Level VI	**Self-Regulation**
	By-laws, Rules and Regulations and Code of Conduct issued by the various Financial Service Industry Associations.

The regulatory framework relating to financial services can be broadly classified into three main types. One set of regulations determine the types of activities that different forms of institution are permitted to engage in. These regulations can be called as ***structural regulations***. For example, the Securities and Exchange Board of India (SEBI) insists that merchant bankers and stock broking institutions, separate all their fund-based activities. Similarly, the Reserve Bank of India (RBI) has prescribed the activities that commercial banks can provide to the investors. Structural regulation thus involves demarcation lines between the activities of financial institutions but many of them have in fact been eroding in recent years. Banks are now providing various services like leasing, term loan, credit cards, etc., in addition to their traditional service of working capital lending. The rationale behind expanding the activities that can be provided by the financial service companies is the desire of regulatory authorities to create greater competition.

There are regulations that cover the internal management of financial institutions and other financial service organisations in relation to capital adequacy, liquidity and solvency. The SEBI for instance has prescribed minimum net worth requirement for various financial service firms that come under its jurisdiction. The objective of these regulations is to restrict the firms without adequate resources from entering into this field. Recently, the RBI has regulated the non-banking finance companies in raising public deposits. These regulations are known as ***prudential regulations*** as they aim to evolve certain prudential norms for the operation of the industry.

There are number of ***investor protection regulations***. All regulatory agencies in the financial sector claim that the primary objective of the agency is to protect the interest of investors. It is generally perceived that investors are the weakest participants of the financial markets and hence need protection from malpractice, fraud and collapse. The information asymmetry between the investors and financial intermediary or institution affects the investors and thus regulatory agencies step-in to protect the interest of the investors. Thus, investor protection regulations are often in the nature of demanding larger disclosure of information.

The regulations can also be classified on their scope. There are regulations which deal with the macro aspects of the system. For example, legislation enacted in the parliament like Banking Regulation Act, Securities Contracts Regulation Act, etc., deal with the macro aspects of respective institutions. The regulatory authorities under the legislation evolve rules, guidelines and regulations that govern the micro aspects and operational issues. In addition to the regulations stated above, there are self-regulations from the industry association. For example, the foreign exchange dealers have their own self-regulation in addition to several other laws and guidelines that govern their activities. The RBI has recognized Micro Finance Institutions Network (MFIN) as India's first Self-Regulatory Organization (SRO) for the NBFC-MFIs. Similarly; the Association of Merchant Bankers of India (AMBI) has been granted recognition by SEBI to establish standard practices in merchant banking and financial services. In the US and other developed markets, there are associations for financial analysts which admit the members after they pass examination and evolve code of conducts when they desire to practice as financial analyst. Table 3.2 gives a list of self Regulatory organizations under different Regulators**.**

Table 3.2 : Self Regulatory organizations under different Regulators

Regulator	**Self regulatory organization under respective regulators**
Reserve Bank of India	i) Micro Finance Institutions Network (MFIN) ii) Sa-Dhan powers to monitor microfinance institutions
SEBI	i) Association of Merchant Bankers of India (AMBI) ii) Association of Mutual Funds of India (AMFI) iii) Association of Custodial Agencies of India (ACAI) iv) Registrars Association of India (RAIN)

IRDAI	i) The General Insurance Council is a Self-Regulatory Organization for the non-life insurance industry's market conduct and practices. ii) Insurance Broker's Association of India. iii) Institute of Actuaries of India(IAI)

The regulations in general aim to ensure the soundness and safety of financial institutions, maintain the integrity of the transmission mechanism and protection of the consumers of financial services. The regulations also ensure freedom of operation to improve the efficiency and provide adequate scope for innovation that benefit the investors and other participants. The success of the regulation thus not only depends on its ability to ensure investors protection but is also determined by the level of advancement and sophistication the system has achieved. In other words, regulation should not block the development of financial service industry. Financial services sector firms are increasingly utilising technology to improve their services. However, IT failures, or incidents within the financial services sector appear to be becoming more common. It is in this background recently, the Reserve Bank of India (RBI) released guidelines to regulate payment aggregators (PAs) and payment gateways (PGs).

Activity 3.1

a) State the broad objectives of regulations relating to financial services.

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b) Give a few examples of prudential regulations relating to stock broking service.

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c) Why do we need regulators when there are comprehensive legislation covering different financial services?

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3.3 REGULATIONS ON BANKING AND FINANCING SERVICES

Financial intermediaries mobilise savings and allocate (lend) capital to different users. Savings and capital allocation are two important activities of the economy and they together determine the growth of the economy. Often, these two are used to change the direction of the economy to achieve desired results. The Governments all over the world frame the polices relating to savings and capital allocation but entrust the responsibility of monitoring them to the central bank. In India, the Reserve Bank of India, as the central bank of the country, is the nerve centre of the Indian financial system. It regulates all institutions that are connected with savings and capital allocation.

By regulation, it does not mean that RBI determines the rate of interest on deposits and /or rate of interest to be charged on advances. While in a closed economy, these are determined by the government whereas in a free-market economy to which India is slowly moving, these are by and large determined by the market forces. The role of RBI is to frame regulations that help the orderly functioning of the institutions that raise and lend the capital. Commercial banks and Non-Banking Financial Institutions are two major set of institutions that come under the regulation of RBI.

a) **Banking Institutions**

The regulation and supervision of the financial system in India is carried out by different regulatory authorities. The Reserve Bank regulates and supervises the major part of the financial system. The supervisory role of the Reserve Bank covers commercial banks, Urban Cooperative Banks (UCBs), some FIs and NBFCs.

Co-operative banks provide banking facilities to people of small means. However, absence of regulatory oversight by RBI on par with commercial banks has contributed to the poor performance of co-operative banks. The Banking Regulation (Amendment) Bill, 2020 was introduced in the Loksabha on 14th September 2020. The Parliament received the assent of the President on the 29th September, 2020 It is now an Act. The said Act seeks to extend RBI regulation of co-operative banks with respect to management, capital, audit and winding up. Currently, RBI regulates and supervises 86 Scheduled Commercial Banks, 45 Regional Rural Banks and 10 Small Finance Banks. The Act extends RBI's regulation and supervision to 1,544 UCBs, 363 district (central) Cooperative Banks and 33 State Co-operative Banks.

State Cooperative Banks and District Central Cooperative Banks are registered under the provisions of State Cooperative Societies Act of the State concerned and are regulated by the Reserve Bank. Powers have been delegated to National Bank for Agricultural and Rural Development (NABARD) under Sec 35 (6) of the Banking Regulation Act (As Applicable to Cooperative Societies) to conduct inspection of State and Central Co-operative Banks.

In order to develop a sound banking system in the country, the RBI regulates the commercial and co operative banking institutions in the following ways:

1) It is the licensing authority to sanction the establishment of new bank or new branch;

2) It prescribes the minimum capital, reserves and use of profits and reserves, distribution of dividends, maintenance of minimum cash reserves and other liquid assets;

3) It has the authority to inspect or conduct investigation on the working of the banks;

4) It has the power to control the appointment of Chairman and Chief Executive Officer of the private banks and nominate members in the Board of Directors.

5) It regulates factoring, bill discounting and credit card services offered by the commercial banks and other institutions.

The central bank also effectively regulates the credit flows through monetary policy. It controls the amount available for credit by prescribing cash reserve ratio and statutory liquidity ratio. It also takes away cash through treasury operations by periodically issuing bonds and REPOS. It also intervenes in the credit flows, by prescribing limits of credit availability to different sectors and industries or increases the bank rate to make credit unattractive. The list of techniques used to control the credit flows are :

a) Open Market Operations,

b) Bank Rate,

c) Discretionary control of Refinance and Rediscounting,

d) Cash Reserve Ratio,

e) Statutory Liquidity Ratio,

f) Direct Credit Allocation and Credit Rationing,

g) Selective Credit Controls and

h) Moral Suasion.

b) **Non-banking Financial Companies**

The contribution of NBFCs towards supporting real economic activity and their role as a supplemental channel of credit intermediation alongside banks is well recognized. Over the years, the sector has undergone considerable evolution in terms of size, complexity, and interconnectedness within the financial sector. Many entities have grown and become systemically significant and hence there was a need to align the regulatory framework for NBFCs keeping in view their changing risk profile. The Scale Based Regulation (SBR) framework encompasses different facets of regulation of NBFCs covering capital requirements, governance standards, prudential regulation, etc.

In India, four types of non-banking financial companies (NBFCs), *viz*., equipment leasing companies, hire-purchase companies, loan companies and investment companies are under the regulatory purview of the Reserve Bank. With the increasing services sector activity in India, the NBFCs have been playing a critical role in providing credit. NBFCs have extensive networks. The insertion of chapter III B in the Reserve Bank of India Act, 1934 enabled the Reserve Bank to regulate the NBFCs statutorily since February 1964. Since then, the Reserve Bank has initiated a series of measures to appropriately regulate and supervise the NBFCs according to the need from time to time. In 1966, new directives were issued to increase the regulatory powers of the Reserve Bank with regard to NBFCs. Earlier National Housing Bank (NHB) was empowered under the provisions of the NHB Act, 1987 to regulate the housing finance companies. However, the provisions of National Housing Bank Act, 1987 were amended w.e.f August 09, 2019, pursuant to the Finance Act, 2019 thereby shifting the power to govern Housing Finance Companies (HFCs) from National Housing Bank (NHB) to the Reserve Bank of India (RBI). Consequently, RBI, on October 22, 2020 issued the Regulatory Framework for HFCs.

In addition to the regulation prescribed by the RBI, there are several Acts and regulations that govern different types of Non-Banking Financial Companies. For example, leasing companies have to take into account the provisions of The Indian Contract Act, Motor Vehicles Act, Indian Stamp Act, etc. Similarly, hire-purchase transactions are governed by the Indian Contract Act, Sale of Goods Act and Hire-Purchase Act. The SEBI also regulates all these companies whenever they approach the market to raise capital.

In the wake of failure of some NBFCs and loss of depositors' money, the supervision of NBFCs assumed critical importance. In the backdrop of the recommendations of the Khanna Committee (1999), a comprehensive supervisory model has been devised for effective supervision of the NBFCs depending upon the size, type of activity and acceptance or otherwise of public deposits.

For this purpose, a four-pronged mechanism comprising onsite inspection on the CAMELS (Capital adequacy, Asset quality, Management, Earning, Liquidity and Sensitivity) pattern, off-site monitoring through periodic control returns using state-of-the-art information technology; an effective market intelligence network; and a system of submission of exception reports by statutory auditors of NBFCs were instituted in order to support the regulatory and supervisory framework for NBFCs. The system of on-site examination is structured on the basis of CAMELS approach and the same is akin to the supervisory model adopted for the banking system. The inspection policy of the NBFCs has recently been revised to regulate them effectively. In order to bring the functioning of the NBFCs in line with international best practices, the Reserve Bank initiated a consultative process with the NBFCs with regard to their plan of action for voluntarily phasing out of their acceptance of public deposits. Recently, the Reserve Bank has laid down a road map for Residuary Non-Banking Companies (RNBCs) with a view to ensure that the transition process of these institutions complies with the Reserve Bank's directions.

RBI has been maintaining its surveillance on NBFCs on an ongoing basis and intervenes whenever action is warranted. For example In January 1998, the Reserve Bank issued a new regulatory framework for NBFCs building upon its newly acquired powers under the RBI Act. It categorized NBFCs into

i) public deposit accepting,

ii) non-public deposit accepting but engaged in loan, investment, hire-purchase and equipment leasing, and

iii) non-public deposit accepting core investment companies that acquire securities/ shares in their own group companies comprising not less than 90 per cent of their total assets but not trading in these securities/ shares.

In 2006, considering the increasing significance of the sector, the Reserve Bank introduced differential regulation and classified NBFCs with asset size of Rs. 100 crore and above as 'Systematically Important NBFC-ND (NBFC-ND-SI)'. Prudential regulations such as capital adequacy requirements and exposure norms were made applicable to them. In 2014 regulatory guidelines were revised, minimum Net Owned Funds (NOF) of Rs. 2 crore for legacy NBFCs, was introduced. Minimum Capital requirements for each type of NBFC varying from Rs.2 crores to Rs 300 crores was introduced for 7 types of NBFCs.

In 2019, the NHB Act was amended and certain powers for regulation of Housing Finance Companies (HFCs) were conferred with the Reserve Bank of India pursuant to such amendments.

A Revised Regulatory Framework for NBFCs from October 2021

With effect from 1-10-2021 RBI has adopted a revised regulatory framework for NBFCs. The highlights of the new framework are that the Regulatory structure for NBFCs shall comprise of four layers based on their size, activity, and perceived riskiness. NBFCs will now be classified as, Base Layer, Middle Layer, Upper Layer & Top Layer.

- **The Base Layer shall comprise of**
  - non-deposit taking NBFCs below the asset size of Rs.1000 crore and
  - NBFCs undertaking the activities such as NBFC-Peer to Peer Lending Platform (NBFC-P2P), NBFC-Account Aggregator (NBFC-AA), Non-Operative Financial Holding Company (NOFHC) and NBFCs not availing public funds and not having any customer interface

- **The Middle Layer** shall consist of
  - all deposit taking NBFCs (NBFC-Ds), irrespective of asset size,
  - non-deposit taking NBFCs with asset size of Rs1000 crore and above and
  - NBFCs undertaking the following activities (i) Standalone Primary Dealers (SPDs), (ii) Infrastructure Debt Fund - Non-Banking Financial Companies (IDF- NBFCs), (iii) Core Investment Companies (CICs), (iv) Housing Finance Companies (HFCs) and (v) Infrastructure Finance Companies (NBFC-IFCs).
- **The Upper Layer** shall comprise of those NBFCs which are specifically identified by the Reserve Bank as warranting enhanced regulatory requirement based on a set of parameters and scoring methodology. The top ten eligible NBFCs in terms of their asset size shall always reside in the upper layer, irrespective of any other factor.
- **The Top Layer** will ideally remain empty. This layer can get populated if the Reserve Bank is of the opinion that there is a substantial increase in the potential systemic risk from specific NBFCs in the Upper Layer. Such NBFCs shall move to the Top Layer from the Upper Layer

RBI Regulatory framework has now specified certain changes under scale based regulation (SBR) for the layers. As of now the minimum net owned fund requirement was varying between Rs 2 crores to Rs 5 crores, By march 31st 2027 all NBFCs are required to maintain minimum net owned funds to the tune of Rs 10 crores. RBI has prescribed a glide path to achieve this. A glide path is provided to NBFCs in Base Layer to adhere to the 90 days NPA norm to achieve by 31-03-2026. Large Exposure Framework (LEF) for NBFCs placed in the Upper Layer has been introduced. Full details of revised regulatory guidelines are available in RBI circular dated 22-10-2021.

3.4 REGULATIONS ON INSURANCE SERVICES

Before the nationalisation of life and general insurance and the setting up of LIC in1956 and GIC in 1973 as monolithic institutions, insurers were regulated under the provisions of the Insurance Act, 1938 which was administered by the Controller of Insurance. The application of the Act was greatly modified by the nationalisation of the insurance companies and most of the regulatory functions were taken away from the Controller of Insurance and vested with LIC and GIC. In order to improve the efficiency of insurance services in India, the Government of India had appointed a committee headed by R.N. Malhotra, the former Governor of Reserve Bank of India in April 1993. The Malhotra Committee submitted its report in January, 1994 suggesting a comprehensive framework covering the entire gamut of life and general insurance. The Committee had recommended that private and foreign companies be allowed to enter into insurance sector. It also recommended to reduce the government holding in the LIC and GIC to 50% and mandated investments from 75% to 50% for LIC and 70% to 35% for GIC and its subsidiaries. It also required the government to appoint a strong and effective Insurance Regulatory Authority in the form of statutory autonomous board on the lines of SEBI and the Tariff Advisory Committee be delinked from the GIC and function as a separate authority under the regulator. With an objective of reforming the insurance sector and allowing private entrants, the Government of India had set up an interim Insurance Regulatory Authority (IRA) in January, 1996 and introduced the Insurance Regulatory Authority Bill, in December 1996 to give statutory status.

The IRDA Bill was passed in December 1999 and became an Act in April 2000. In July 2000, immediately after the first meeting of the Insurance Advisory Committee, 11 essential regulations relevant for players entering the Indian market were notified. At the time of opening of the insurance sector, supervision and regulation of insurance was a relatively new experience in India. It is the job of the Regulator to ensure that the insurers have, at any point of time, sufficient resources to meet the liabilities and that all customers are treated in a fair and equitable manner. The Regulations framed by the Authority deal with both the issues in a comprehensive way. The former is addressed by stipulating a high level of capital requirement for entry of private insurers into the field and rigorous enforcement of the solvency and investment requirements. The latter is covered by the regulatory framework put in place for protection of policyholders' interests. The Insurance Regulatory and Development Authority of India (IRDAI) is an autonomous and statutory body which is responsible for managing and regulating insurance and re-insurance industry in India.

The regulatory framework for Insurers includes

a) Registration / Renewal / Cancellation of registration

b) Opening and Closing of offices

c) Clearance of insurance products

d) Monitoring of Advertisements / publicity material of products

e) Solvency requirements

f) Investment norms

g) Accounting norms

h) Reinsurance requirements

i) AML - CFT Norms

j) Policyholder protection regulations

k) Corporate Governance guidelines

l) Penalties for non-compliance or violations

The IRDAI regulations govern all insurance agents and intermediaries, that is:

1) corporate agents;

2) insurance brokers;
3) insurance marketing firms (IMFs);
4) Third party administrators (TPAs)
5) surveyors and loss assessors; and
6) web aggregators.
7) Micro insurance agents

The IRDAI has issued regulations setting out the licensing or registration requirements (including eligibility criteria, capital and net worth requirements, qualification requirements of the principal officer, directors or partners of the concerned entity) and procedures for all the above-mentioned intermediaries. License or registration is typically granted for three years, and may be renewed thereafter.

IRDAI has played a vital role in the growth and development of the insurance sector in the country. It has through its policy initiatives protected policyholders' interests; It has regulated insurance companies effectively. Introduced licensing and established norms for insurance intermediaries. It has overseen premium rates and terms of non-life insurance covers; specified financial reporting norms. It has protected investment of policyholders' funds by ensuring the maintenance of solvency margin by insurance companies; It has taken effective steps in ensuring insurance coverage in rural areas and of vulnerable sections of society. Supervisory role of IRDA includes, on-site inspection, off site monitoring through returns and public disclosures, market conduct based on complaints and market intelligence.

During the year 2020-21, IRDA has notified regulations which came into force from 23rd May 2021which mandates insurers, and insurance intermediaries to maintain minimum information in their books for the purpose of investigation and inspection by the Authority, Through (Insurance Advertisements and Disclosure) Regulations, 2021dated 9th April 2021 IRDA has asked the companies to ensure that the advertisements of Insurance are relevant, fair and in simple language enabling informed decision making by customers.

3.5 REGULATIONS ON INVESTMENT SERVICES

Investment services are primarily fund based activities. The mutual funds and venture capital funds directly fall under the investment services. Though portfolio management service is advisory in nature, the regulation on portfolio management services could be discussed under the heading of investment services as this service is closely linked with the investment services. Similarly, stock exchanges and stockbroking institutions have close link with the investment activities and thus regulation on them could be conveniently discussed along with other direct investment activities. The regulatory set up consists of Securities Contracts (Regulation) Act (SCRA)

1956, SEBI Regulations and Reserve Bank of India. Before discussing the regulatory framework under each of the investment and investment related services, it is appropriate to know Securities and Exchange Board of India which is emerging as a powerful regulator of various financial services.

3.5.1 The Securities and Exchange Board of India (SEBI)

SEBI was founded on April 12, 1992, under the SEBI Act, 1992. The main purpose in establishing SEBI by the Govt. was to stop the malpractices in stock markets. There were malpractices such as price rigging, 'unofficial premium on new issue, and delay in delivery of shares, violation of rules and regulations of stock exchange and listing requirements etc. Due to these malpractices the customers started losing confidence and faith in the stock exchange. Therefore, government of India decided to set up an agency or regulatory body known as Securities Exchange Board of India (SEBI).

The objectives of SEBI are:

1) To regulate the activities of stock exchange.
2) To protect the rights of investors and ensuring safety to their investment.
3) To prevent fraudulent activities and malpractices by having balance between self regulation of business and its statutory regulations.
4) To regulate and develop a code of conduct for intermediaries such as brokers, underwriters, etc.

The three main functions of SEBI are-

- **Protective functions**- Under this function it checks price rigging that is manipulation in prices of securities. It prohibits "insider trading" SEBI keeps a strict check when insiders are buying securities of the company and takes strict action on insider trading because insiders have sensitive information about the company which affects the prices. SEBI does not allow the companies to make misleading statements which are likely to induce the sale or purchase of securities by any other person.

- **Development Functions**-It promotes training of intermediaries of the securities market, through its flexible approach it has permitted internet trading of securities and has made underwriting optional to reduce the cost of issue.

- **Regulatory functions**- SEBI has framed rules and regulations and a code of conduct to regulate the intermediaries. It regulates the working of stock brokers, sub-brokers, share transfer agents, trustees, merchant bankers. SEBI registers and regulates the working of mutual funds. It conducts inquiries and audit of stock exchanges.

Powers of Securities and Exchange Board of India

It has the following three powers:

Quasi-Judicial: SEBI has authority to conduct hearings and pass judgements in cases of unethical and fraudulent trade practices. This ensures transparency, fairness, accountability and reliability in the capital market.

Quasi-Legislative: under this power SEBI can draft rules and regulations for the protection of the interests of the investor.

Quasi-Executive: SEBI is authorised to file a case against anyone who violates its rules and regulations. It is empowered to inspect account books and other documents as well, if it finds traces of any suspicious activity.

SEBI has also created special wings for Primary Market, Secondary Market, Mutual Funds, Surveillance, Research, etc. These regulations and guidelines serve the basic structure of regulatory framework for several financial services. The SEBI Act also provides that parties aggrieved by its order can appeal to the Central Government within a prescribed time limit. The regulations relating to different financial services connected with investment activities are discussed below:

a) Mutual Funds

The mutual funds in India could be broadly classified into three groups for the purpose of regulations governing the mutual funds. They are Unit Trust of India, Public Sector and Private Sector Mutual Funds, and Money Market and Off-Shore Mutual Funds. The Unit Trust of India (UTI) was established by the Government of India as a Trust under UTI Act, 1963. Since inception, the UTI has offered several schemes and it is governed by the UTI Act, 1963. In 1986, the government has allowed the public sector banks to enter into mutual fund service and within a short period of time several public sector banks commenced their mutual fund service. In these public sector banks mutual funds were governed by the Reserve Bank of India. In February, 1992, the Ministry of Finance issued a notification to the effect that all mutual funds be regulated by the SEBI and allowed the private sector entry into mutual funds service.

As far as mutual funds are concerned, SEBI formulates policies, regulates and supervises mutual funds to protect the interest of the investors. SEBI notified regulations for mutual funds in 1993. Thereafter, mutual funds sponsored by private sector entities were allowed to enter the capital market. The regulations were fully revised in 1996 and have been amended thereafter from time to time. SEBI has also issued guidelines through circulars to mutual funds from time to time to protect the interests of investors. All mutual funds whether promoted by public sector or private sector entities including those promoted by foreign entities are governed by the same set of Regulations. There is no distinction in regulatory requirements for these mutual funds and all are subject to monitoring and inspections by SEBI.

Some of the important regulations applicable to mutual funds are:

- Every mutual fund must be registered with SEBI.

- A mutual fund be set up as a trust, with sponsors, trustees, an Asset Management Company ("AMC") and a custodian.
- An AMC of a mutual fund should have at least 50% independent directors, a separate board of trustees which includes 50% independent trustees and independent custodians so as to manage any conflict of interest among fund managers, custodians, and trustees.
- A single mutual fund can float different schemes but they have to be individually approved by the trustees and all offer documents have to be filed with SEBI.
- SEBI lays down certain restrictions on the fees that AMCs can charge for mutual funds and there is also a cap on the expenses that can be added to the fund.
- Mutual funds can advertise, but advertisements cannot have statements that are misleading. For instance, no mutual fund can guarantee a return since returns depend on market performance.

b) Venture Capital Financing (VCF)

Venture Capital is a type of seed funding in which investment is made at the initial growing stage of ventures. The Venture Capital Investors generally place their funds in those companies, which are with new ideas, innovations and having potential of high growth but with inherent uncertainties. Venture Capital Investors are also called as "Angel Investors" Venture Capital institutions participate in the equity of companies which are not in a position to raise equity capital directly from the market due to new technology or small size of the venture in the initial stage. The venture capital institutions sell the equity in the market once the company establishes its standing in the market and normally; such public offers are accompanied with a similar public offering from the company.

In India, venture capital fund is regulated by Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012. Investment in VCF is subject to certain conditions such as, each scheme of VCF is required to have a minimum corpus of INR 200 Million and every investor is required to invest at least INR 10 Million (*except for the employees and directors of VCF who can invest a minimum of INR 2.5 Million*). Further, no scheme can have more than 1000 investors.

The VCF can raise funds from any investor whether Indian, foreign or non-resident Indians by way of issue of units, however, any investment in VCF by a person resident outside India (including a NRI) is governed by Foreign Exchange Management (Non-debt Instruments) Rules, 2019. The venture capitalists have today emerged as the mainstream source of finance for the innovative entrepreneurs thereby providing the requisite solution. The SEBI regulation on VCF prescribes compulsory registration of VCF, investment conditions, management of the company and maintenance of records. It also has an authority to inspect the books and investigate the charges and also take penal action against the erring VCF. In addition to SEBI regulation, the VCFs are also governed by the Income Tax Act. The VCFs are required to apply to the Director of Income Tax (Exemptions) to avail favourable treatment on dividend income and capital gains. The VCFs have to fulfil certain condition laid down under the Act to get such benefits. The Government of India has allowed the overseas venture capital companies to operate in India in 1995 and they require the approval of Foreign Investment Approval Board (FIPB).

c) Portfolio Management Services

The portfolio manager is one who in pursuant to a contract or arrangement with a client advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise) the management or administration of a portfolio of securities or the funds of the client. The SEBI had issued a detailed guideline in 1993 (SEBI Portfolio Managers Regulations, 1993) to regulate this advisory service. The regulation requires compulsory registration of portfolio managers before starting their service, terms and conditions of the schemes that could be offered, managerial requirement, disclosure norms and periodical reporting to SEBI. The commercial banks are also offering portfolio management service to their customers. These services are regulated by the RBI which issued a detailed guideline to regulate this service in 1991.

Guidelines issued by SEBI in 1993 have been replaced by a new set of guidelines viz. Securities and Exchange Board of India (Portfolio Managers) Regulations, 2020. As per these guidelines portfolio managers shall not accept funds or securities worth less than Rs. 50 lakhs in respect of new clients w.e.f 1-10-2020. As per the new regulation, the minimum net worth required for a portfolio manager which was originally Rs. 50, lakhs in 1993 has been revised to Rs 5 crore. Regulations 2020 requires every portfolio manager to appoint a custodian, irrespective of Assets Under Management (AUM), except portfolio managers who provide only advisory services.

d) Stock Broking

The stock brokers who are the members of recognised stock exchanges enable the investors to buy and sell securities in the secondary market. They also act as a broker to the companies which want to raise capital in the primary market. The stock broking service is regulated by the Securities Contracts (Regulation) Act, (SCRA)1956 and its Rules 1957, SEBI (Brokers and Sub-brokers) Regulation 1992, and the by-laws of Stock Exchange where the broker is a member. While the SCRA regulates the stock exchanges, the Securities Contracts (Regulation) Rules, 1957 prescribes the qualification for membership of a recognized stock exchange, books of accounts to be maintained by the members and the minimum number of years the documents and books are to be maintained. The SEBI regulation requires compulsory registration of members of stock exchange and prescribed net-worth requirement and capital adequacy norms, books and records to be maintained and code of conducts to be adopted by the members. The SEBI also has the powers to inspect books and records and investigate the investors and other brokers complaints against the stock broker. The sub-brokers are also governed by the same regulation and SEBI requires them to be registered through a member of stock exchange under whom the sub-broker will transact business. The by-laws of the stock exchange is in the nature of self-regulation and varies from exchange to exchange. It generally prescribes how the members have to conduct the business and deal with other members of the exchange. It also prescribes how disputes between the members, and members and investors are to be settled. In addition to the above three regulations, the members of stock exchange need to have a working knowledge on the Negotiable Instruments Act, 1881, Indian Stamp Act, 1889 as in force in their respective states, and provisions relating to Goods & Services Tax. (GST) released by CBIC (Updated as on 27.12.2018)

Certain new regulatory guidelines those were issued on 20-6-2019, 1-8-2020 and 30-03-2021 briefly stated they are as under

a) Trading member/ clearing members are barred to raise funds from pledging securities of clients lying in the '*client collateral account*', '*client margin trading securities account*' and '*client unpaid securities account*' even with their consent.

b) The new rules will penalise brokers who fail to collect margins up-front for intra-day trades. This will end the practice of brokers allowing clients to conduct leveraged intraday trading in cash segment, without depositing the required margins.

c) Stock broker who acts as an underwriter shall enter into a valid agreement with the body corporate on whose behalf it is acting as underwriter. Further every stock broker acting as an underwriter shall maintain certain books of account and documents.

Activity 3.2

a) Explain the role of RBI, IRDA and SEBI as regulators.

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b) What are the main functions and powers of Securities and Exchange Board of India?

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c) What do you understand by the term stock broking? Are there any regulatory guidelines for this sector? If yes explain in brief

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3.6 REGULATIONS ON MERCHANT BANKING AND OTHER INTERMEDIARIES

There are several intermediaries associated with management of public and rights issue of capital. While the Merchant Banker is the main intermediary, Merchant bankers as defined under the SEBI (Merchant Bankers) Regulations, 1992, have traditionally been in charge of conducting due diligence on all documents relating to the offer prior to IPOs, FPOs, and even right issues. They felicitate in making arrangements regarding buying or selling of securities as well as provide advisory service and portfolio management service to their clients.

Merchant Bankers are also responsible to ensure that companies, that are listing their stock to the public, make adequate disclosure of information to prospective buyers. During the time of submission of the draft red herring prospectus, these merchant bankers are required to file a due diligence certificate. SEBI has entrusted Merchant Bankers with pivotal role in Initial Public Offerings. With a view to provide investors relevant information about the primary market issuances by investment trusts (InvITs), an investor charter has been prepared by markets regulator Securities and Exchange Board of India (SEBI) Through its latest guidelines that has come into effect from January 1, 2022. SEBI has asked all registered merchant bankers to disclose on their websites, the charter for private placement of units by InvITs proposed to be listed. Additionally, in order to bring about transparency in the investor grievance redressal mechanism, the regulator has directed merchant bankers to disclose on their respective websites, the data on complaints received against them or against issues dealt by them.

SEBI has laid down a detailed regulatory framework to govern intermediaries in the capital market and avoid the possibility of default. Various categories of intermediaries are regulated through the following SEBI rules and regulations:

- The SEBI (Stock Brokers and Sub- Brokers) Regulations, 1992;

- The SEBI (Depositories and Participants) Regulations, 1996;
- The SEBI (Bankers to an Issue) Regulations, 1994;
- The SEBI (Merchant Bankers) Regulations, 1992;
- The SEBI (Portfolio Managers) Regulations, 1993;
- The SEBI (Registrar to an Issue and Share Transfer Agents) Regulations, 1993;
- The SEBI (Underwriters) Regulations, 1993.

These regulations provide detailed requirements to make intermediaries eligible for registration along with the compliance requirements that need to be fulfilled during the entire course of functioning, the nature of registration being perpetual or subject to renewal, the required code of conduct during functioning in capital markets. The regulations cover guidelines for maintenance of books of accounts, disclosure requirements, procedure for inspection of accounts and documents, investigation and inquiry process for any alleged default, the conduct of adjudication or disciplinary procedure, orders to enforce the decisions and appeal against such orders.

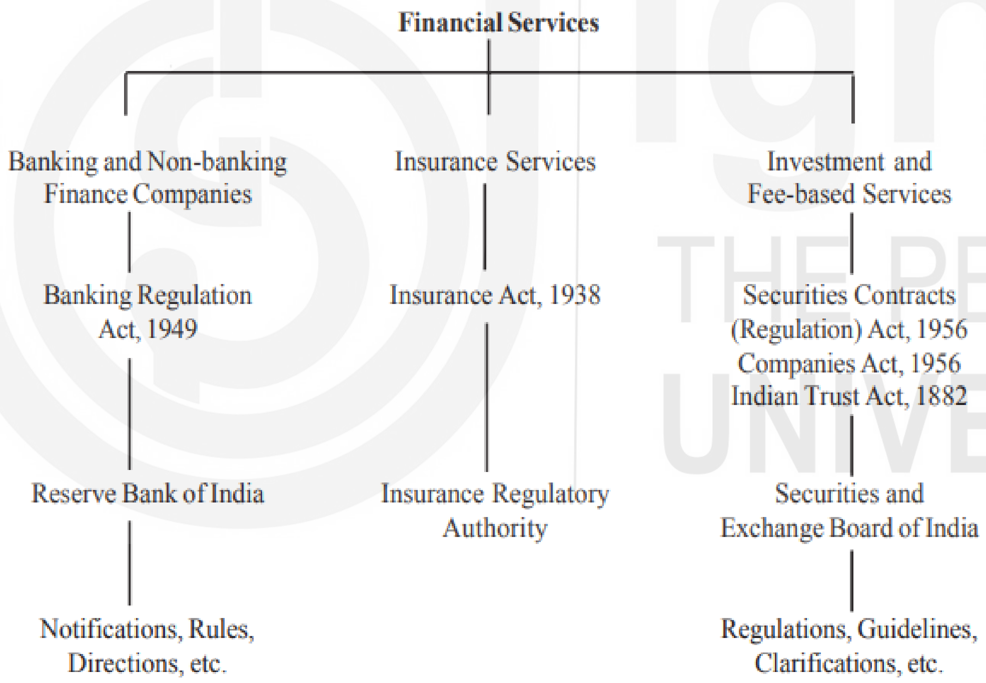

Table 3.3 : A bird's-eye view of Regulation on Financial Services

Activity 3.3

a) The merchant bankers are the main intermediary in stock market. Explain the role played by them relating to capital market

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b) How does SEBI protect the interest of investors?

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c) Apart from merchant bankers who are the other intermediaries in the capital market?

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3.6 SUMMARY

Financial services industry plays an important role in the economic development of the country. If there is any collapse in the financial services industry, it adversely affects the economy. The developments in the East-Asian countries where the failure of banks and other financial services firms have thrown out millions of people from their jobs. The Global Financial Crisis of 2008-2009 is another example of a financial crisis which led to financial market crashes – either widespread or within specific industries – housing market crashes and bank runs. A bank run happens when large numbers of bank depositors panic and seek to withdraw, all at once, all their funds on deposit with their bank a financial crisis commonly leads to a notably severe period of overall economic recession. The securities scam of 1992 and Primary market scam of 1994, in India have affected the industries to raise capital from the public and reduced the level of investments in the economy.

In order to ensure that there is no adverse effect on the economy, the financial services industry is the most regulated segment of the economy all over the world. The objective of the regulation is not to control the growth of the industry and on the contrary allows growth as well as freedom to operate subject to fulfilment of certain conditions. Despite strict regulations, the industry has recorded high level of growth all over the world and efficiency and innovation are the key to the success of the industry. Thus the objectives of the regulations are to ensure orderly growth of the industry, protecting the investors and other participants of the markets and using the industry for the development of the economy.

The regulations can be broadly classified into structural regulations, prudential regulations and investor protection regulations. While the structural regulations cover the main types of activities that different forms of institutions are permitted to engage in, the prudential regulations aim to ensure capital adequacy, liquidity and solvency of the institutions. The investor protection regulations are designed to protect the investors from the frauds, malpractice and collapse. There are three forms of regulations that govern the financial industry. At the macro level, the legislation passed by the Parliament gives a general regulatory framework and stipulate the government agency which is in charge for administrating the provisions of the Act. The regulatory agencies set up by the government like SEBI frame several regulations at micro level and these regulations, guidelines and notifications constitute the second form of regulation. The third form of regulation is in the nature of the industry association frame the operating system of the industry, code of conduct to their members and procedure for settling the dispute between the members.

The Banking Regulation Act 1949, Insurance Act 1938, and Securities Contracts (Regulation) Act 1956, provides macro level regulation on banking, insurance and securities markets transactions. The Reserve Bank of India, Insurance Regulatory Authority and Securities and Exchange Board of India are the major regulators of the industry. They have issue a number of regulations, guidelines, notifications, clarifications, etc., that govern the activities of the financial service providers. The stock exchanges, Merchant Banking Association, Foreign Exchange Dealers Association, Equipment Leasing Companies Association, etc., have formed separate by-laws and regulations that govern their members. All these regulations play a vital role for the development of the financial service industry.

3.8 KEY WORDS

Structural Regulation determines the type of activities that different forms of institutions are permitted to engage in.

Prudential Regulation covers the internal management of financial service providers in relation to capital adequacy, liquidity and solvency.

Investors' Protection Regulation determine the nature and level of disclosure to be made by the financial service providers to the investors.

Banking Regulations consisting of Banking Regulation Act, 1949 and Directions from the Reserve Bank of India, govern the activities of the banking companies.

NBFC Regulations are those directions given by the RBI to regulate different forms of Non-banking financial companies.

Insurance Regulatory and Development Authority (IRDA) set up as autonomous body under the IRDA Act, **1999** To protect the interests of policyholders, to regulate, promote and ensure orderly growth of the insurance industry and for matters connected therewith or incidental thereto.

SEBI is a statutory body that regulate the securities markets and their participants with a main objective of protecting the interest of investors.

SEBI Regulations are set of regulations and guidelines issued by the SEBI on various investment institutions and market intermediaries.

Self Regulations are those framed by various industry association that govern its members activities, code of conduct and settlement of disputes between them.

3.9 SELF ASSESSMENT QUESTIONS

1) Why scams and defaults occur quiet frequently in the financial service industry despite regulations?
2) How do you classify the existing regulations governing the financial service industry on the basis of their scope?
3) What is the role of regulations in a free market economy?
4) How does SEBI regulate fund-based and fee-based activities?
5) What are the objectives of self-regulations? Do you feel self-regulations are better than formal regulations?
6) What steps have been initiated by RBI to regulate electronic payment transactions?

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