



INDIAN FINANCIAL SYSTEM



LEARNING OUTCOMES

After going through the chapter student shall be able to understand:

- ☐ Introduction to Indian Financial System
- ☐ Role of financial market in economic development

OVERVIEW OF FINANCIAL SYSTEM

Efficient financial systems are indispensable for speedy economic development. The more vibrant and efficient the financial system in a country, the greater is its efficiency of capital formation. The more diversified and broad based the institutional structure of the financial system, the more active and vibrant is the financial system. The overall macro level policies of the government, scope of services and operations of financial intermediaries, global outlook regarding the economy, diversity in investment avenues, income and saving levels of households and business and overall regulatory setup affect the process of capital formation in the country. They facilitate conversion of savings into investments by overcoming the geographical and technical limitations.



1. INTRODUCTION TO FINANCIAL SYSTEM

India has seen vast changes in its economic setup post independence. However, the first three decades saw India's GDP growth rate hovering between 3-4% per annum. Some initiatives were taken in 1980's for the upliftment of the economy that actually pushed the GDP to 5.6%. But, to obtain overall growth and development of the economy that can put India on the Global Map, India needs efficient financial systems. In this respect, efforts were made in 1991 through the policy of Liberalization, Privatization and Globalization. That has, indeed, put India on the global platform.

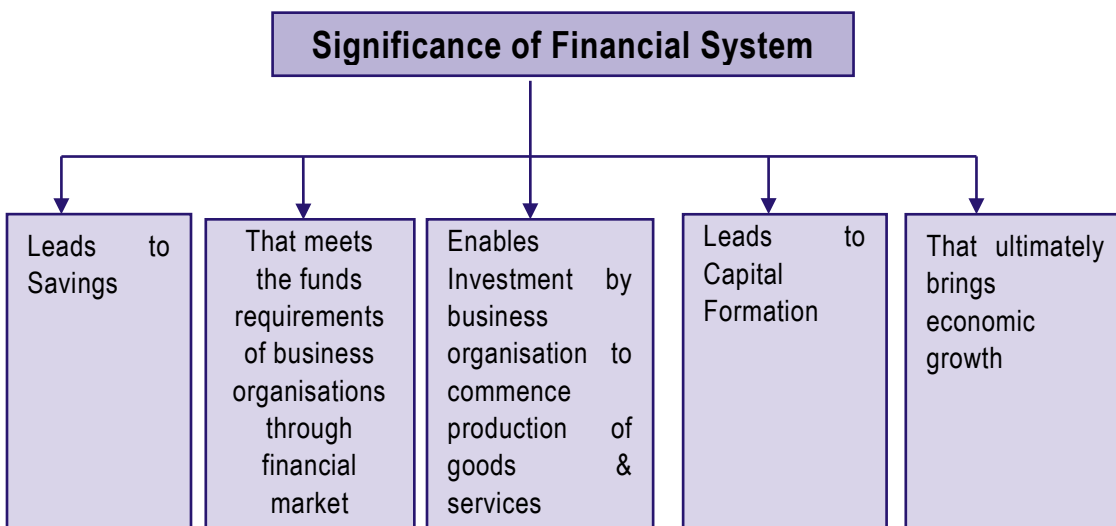
The financial system is possibly the most important institutional and functional vehicle for economic transformation. Further, for mobilization of savings and their efficient, effective and equitable allocation for investment, it is the success with which financial system performs its functions that sets the pace for the achievement of economic growth and development of a nation.

1.1 Significance and Definition

Financial system is a system of interrelated activities that work together to achieve a predetermined goal. It includes financial market, financial institutions, financial services and financial instrument which influence the generation of savings, investment, capital formation and growth.

Van Horne defined the financial system as the purpose of financial markets to allocate savings efficiently in an economy to ultimate users either for investment in real assets or for consumption. *Christy* has opined that the objective of the financial system is to "supply funds to various sectors and activities of the economy in ways that promote the fullest possible utilization of resources without the destabilizing consequence of price level changes or unnecessary interference with individual desires." According to *Robinson*, the primary function of the system is "to provide a link between savings and investment for the creation of new wealth and to permit portfolio adjustment in the composition of the existing wealth."

From the above definitions, it may be said that the primary function of the financial system is the mobilization of savings, their effective utilization for investment in various sectors of the economy and stimulating capital formation to accelerate the process of economic growth. The significance of financial system as explained above can be graphically depicted in the following diagram.

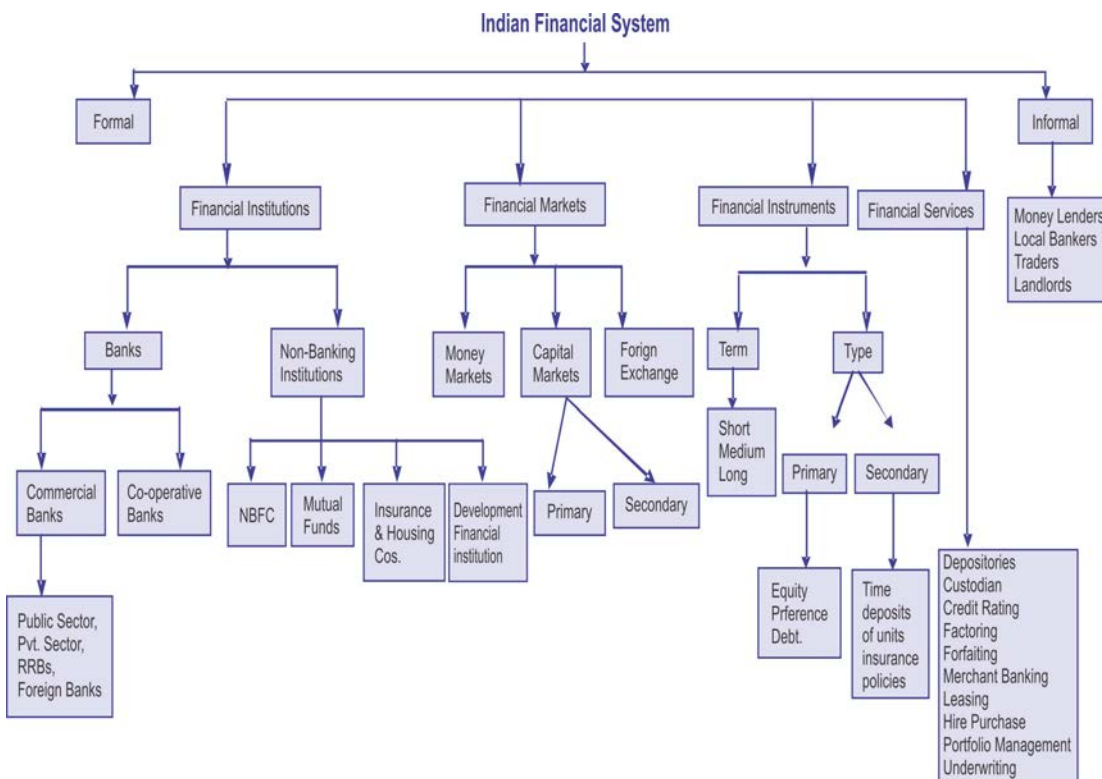


1.2 Inter-relationship in the Financial System

A financial system provides services that are essential in a modern economy. Financial instruments (equity, debt etc.) with attractive return and liquidity encourage saving in financial form. By evaluating alternative investments and monitoring the activities of borrowers, financial institutions increase the efficiency of resource use. Access to a variety of financial instruments enables an organization to pool resources in the markets. Further, trade, the efficient use of resources, saving and risk taking are the cornerstones of a growing economy. In fact, the country could make this feasible with the active support of the financial system. Thus, the financial system has been identified as the most refurbishing factor for growth of the economy, making it one of the important inputs for development.

1.3 Liberalization of the Financial System

A profound overhaul of the economic system consisting of industrial deregulation, liberalization of policies relating to foreign direct investment, public enterprise reforms, reforms of taxation system, trade liberalization and financial sector reforms have been initiated in 1992-93. Financial sector reforms in the area of commercial banking, capital markets and non-banking finance companies have also been initiated.



The focus of reforms in the financial markets has been on removing the fundamental weaknesses and developing the financial markets on sound lines. The money and foreign exchange market reforms have attempted to broaden and deepen them. Reforms in the government securities market sought to smoothen the maturity structure of debt, raising of debt at close-to-market rates and improving the liquidity of government securities by developing an active secondary market. In the capital market the focus of reforms has been on strengthening the disclosure standards, developing the market infrastructure and strengthening the risk management systems at stock exchanges to protect the integrity and safety of the stock market. Elements of the structural reforms in various market segments are introduction of free pricing of financial assets such as interest rate on government securities, pricing of capital issues and exchange rate, the enlargement of the number of participants and introduction of new instruments.

Improvement in the financial soundness and credibility of banks is a part of banking reforms undertaken by the RBI, a regulatory and supervisory agency over commercial banks under the Banking Companies Regulation Act 1949. The improvement of financial health of banks is sought to be achieved by capital adequacy norms in relation to the risks to which banks are exposed, prudential norms for income recognition and provision of bad debts. There is a need to further improve financial soundness and to measure up to the increasing competition that a fast liberalizing and globalizing economy would bring to the Indian banking system.

In the area of capital market, the Securities and Exchange Board of India (SEBI) was set up in 1992 to protect the interests of investors in securities and to promote development and regulation of the securities market. SEBI has issued guidelines for primary markets, ensuring safe and easy access to capital market to improve the quality of public issues, allotment of shares, private placement, book building, takeover of companies and venture capital. In the area of secondary markets, measures to control volatility and transparency in dealings by prohibiting the badla system, laying down insider regulations to protect integrity of markets, rolling settlement by introduction of T + 2, custodians, introduction of screen-based online trading, dematerialization of shares by setting up depositories and trading in derivative securities (stock index futures) and enable an efficient and safe clearing and payment system. There is a sea change in the institutional and regulatory environment in the capital market area.

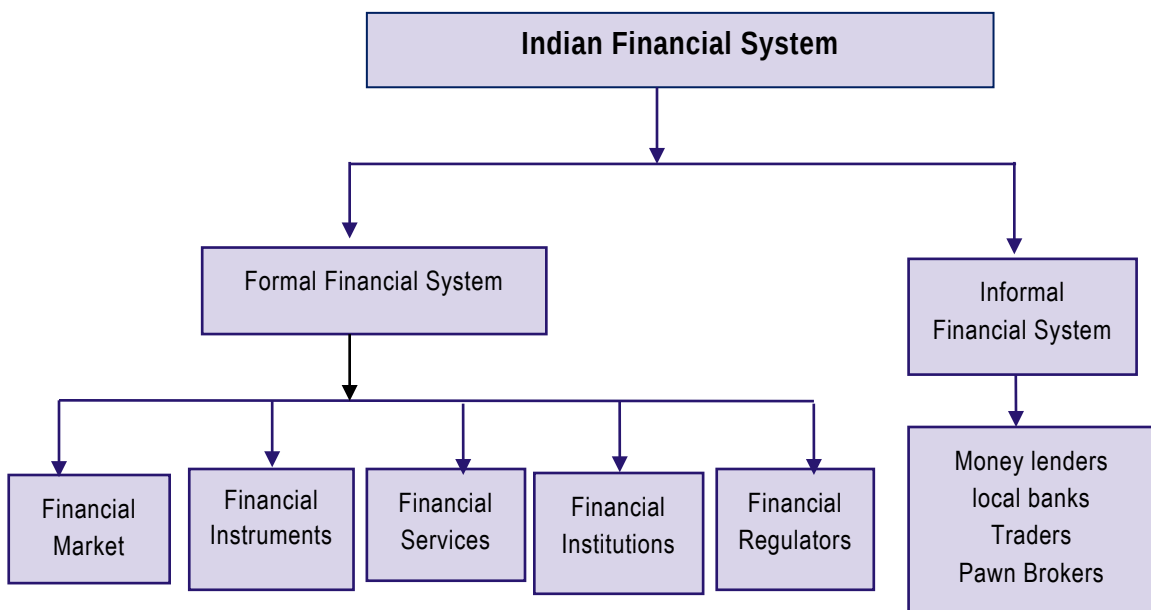
In regard to Non-Bank Finance Companies (NBFCs), the Reserve Bank of India has issued several measures aimed at encouraging disciplined NBFCs which run on sound business principles. The measures seek to protect the interests of depositors and provide more effective supervision, particularly over those which accept public deposits. The regulations stipulate an upper limit for public deposits which NBFCs can accept. This limit is linked to credit rating by an approved rating agency. An upper

limit is also placed on the rate of interest on deposits in order to restrain NBFCs from offering incentives and mobilizing excessive deposits which they may not be able to service. The heterogeneous nature, number, size, functions (deployment of funds) and level of managerial competence of the NBFCs affect their effective regulation.

Since the liberalization of the economy in 1992-93 and the initiation of reform measures, the financial system is getting market-oriented. Market efficiency would be reflected in the wide dissemination of information, reduction of transaction costs and allocation of capital to the most productive users. Further, freeing the financial system from government interference has been an important element of economic reforms. The economic reforms also aim at improved financial viability and institutional strengthening. To improve the effective implementation of the monetary policy, money market and foreign exchange markets have been linked.

1.4 Types of financial system

The Indian financial system consists of formal and informal financial system which is depicted in the following figure:



(i) Informal Financial System

From the above diagram, it can be easily understood that the Indian Financial System can be categorized into formal and informal financial system. The Informal financial system consists of moneylenders; Associations, funds, clubs, committees etc. These people have a system and they have their own rules on how they should function in their day to day activities.

Moreover, informal financial system responds quickly to short term financing opportunities and allowed low income people access to service not available to them through the formal channel. Another advantage is that in informal financial system, loans were given quickly to the lenders. Also, informal financial markets are not subject to interest rate regulation. They do not incur legal expenses and their cost of lending and deposit taking tends to be lower than that of formal financial institutions. However, the formal financial system is always preferable because it is systematic and transparent and offers numerous benefits.

(ii) Formal Financial System

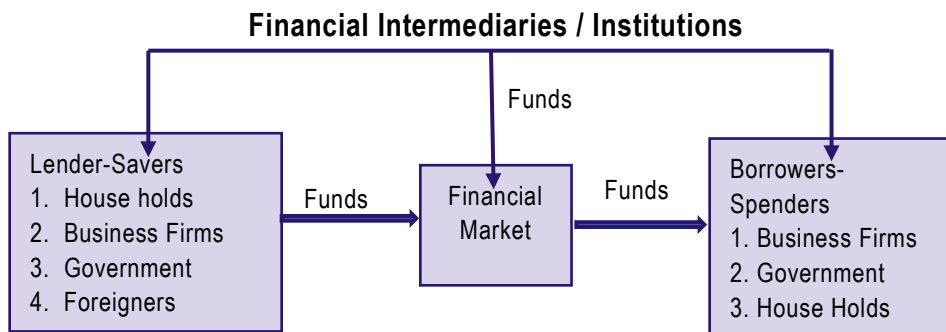
The formal financial system consists of financial institutions, financial markets, financial instrument, and financial services.

1.5 Segregation of Formal Financial System

The formal financial system can be segregated into following sub-systems:

(i) Financial Institutions

First of all let us get some idea about the concept of financial institutions by going through following diagram:



Flow of Funds through the Financial Intermediaries Source: 'Indian Financial System' M.Y. Khan

Financial Institutions can be classified as banking and non-banking financial institutions. Banks are creators and providers of credit. While non-banking financial companies are only providers of credit. Financial institutions can be specialized financial institutions like Export Import Bank of India (EXIM), Tourism Finance Corporation of India (TFCI), the Infrastructure Development Finance Company (IDFC) etc. They can also be sector based such as National Bank for

Agriculture and Rural Development (NABARD) and the National Housing Bank (NHB). Further, Unit Trust of India (UTI) which is in the business of mutual fund, Life Insurance Corporation (LIC) and General Insurance Corporation (GIC) and its subsidiaries are also classified as financial institutions. Therefore, the financial institutions can be categorized into banking institutions and non-banking institutions.

(a) Banking Financial Institutions

Banking institutions are those institutions, which participate in the country's payment system, i.e. they provide transaction services. They play an important role in the mobilization of deposits and distribution of credit to various sectors of the economy. A sound banking system ensures that deposits accumulated from people are productively utilized. Banking sector is dominant in India as it accounts for nearly half of the total financial assets in the financial sector.

(b) Non-Banking Financial Institutions

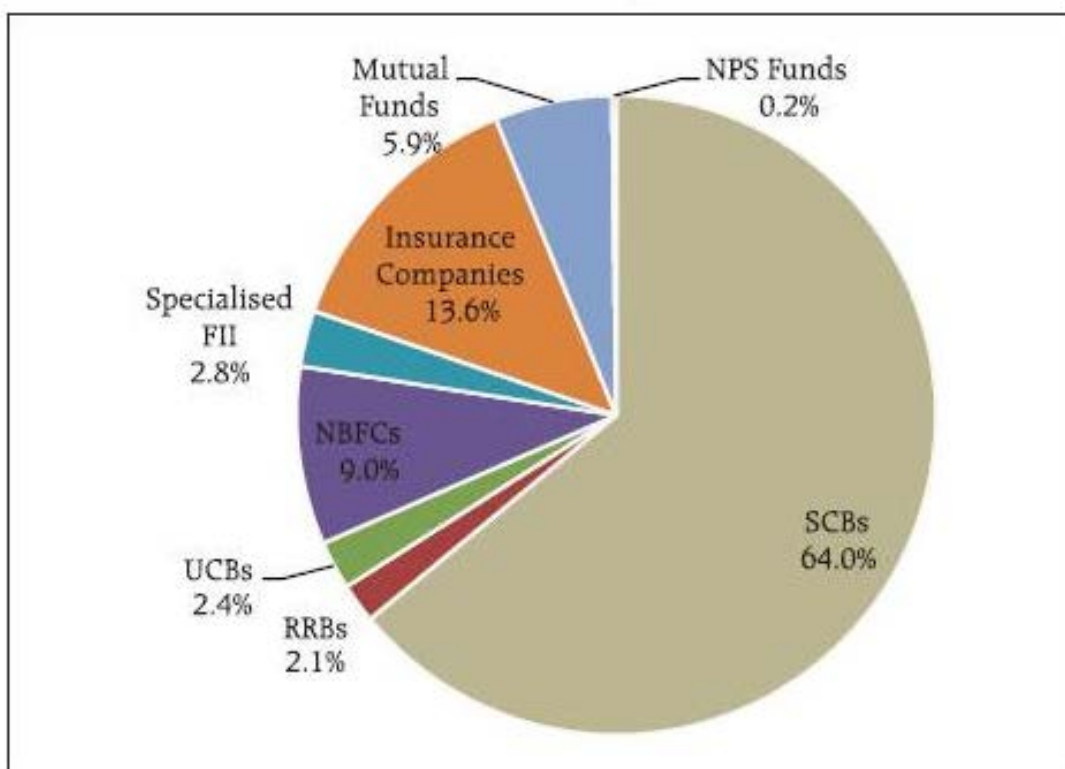
Non-banking financial institutions are those institutions which act as mere providers of credit and they do not create credit, e.g., LIC, UTI, and IDBI.

COMPARISON BETWEEN BANKING AND NON-BANKING INSTITUTIONS

Basis for comparison	Banking Institutions	Non-Banking Institutions
Meaning	Bank is a financial intermediary which provides banking services to general people. And it requires a bank license for that.	Non-banking institutions are basically company form of organization that provides banking services to people without holding a banking license.
Transaction Services	Banks provide transaction services like providing overdraft facility, issue of cheque books, travelers cheque, demand draft, transfer of funds, etc.	The non-banking institutions do not provide any transaction services.
Money supply	Bank deposits constitute a major part of the national money supply.	The money supply of the nonbanking institutions is small.
Credit creation	Banks create credit.	Non-banking institutions do not

		create credit.
Compliance	Banks are required to comply with some of the legal requirements like Cash Reserve Ratio (CRR), Statutory Liquidity Ratio and Capital Adequacy Ratio (CAR).	Non-banking institutions are not required to comply with these legal requirements.
Demand Deposit	They are not accepted.	They are accepted.
Payment and settlement system	Contains an integral part of the system.	Not a part of the system.

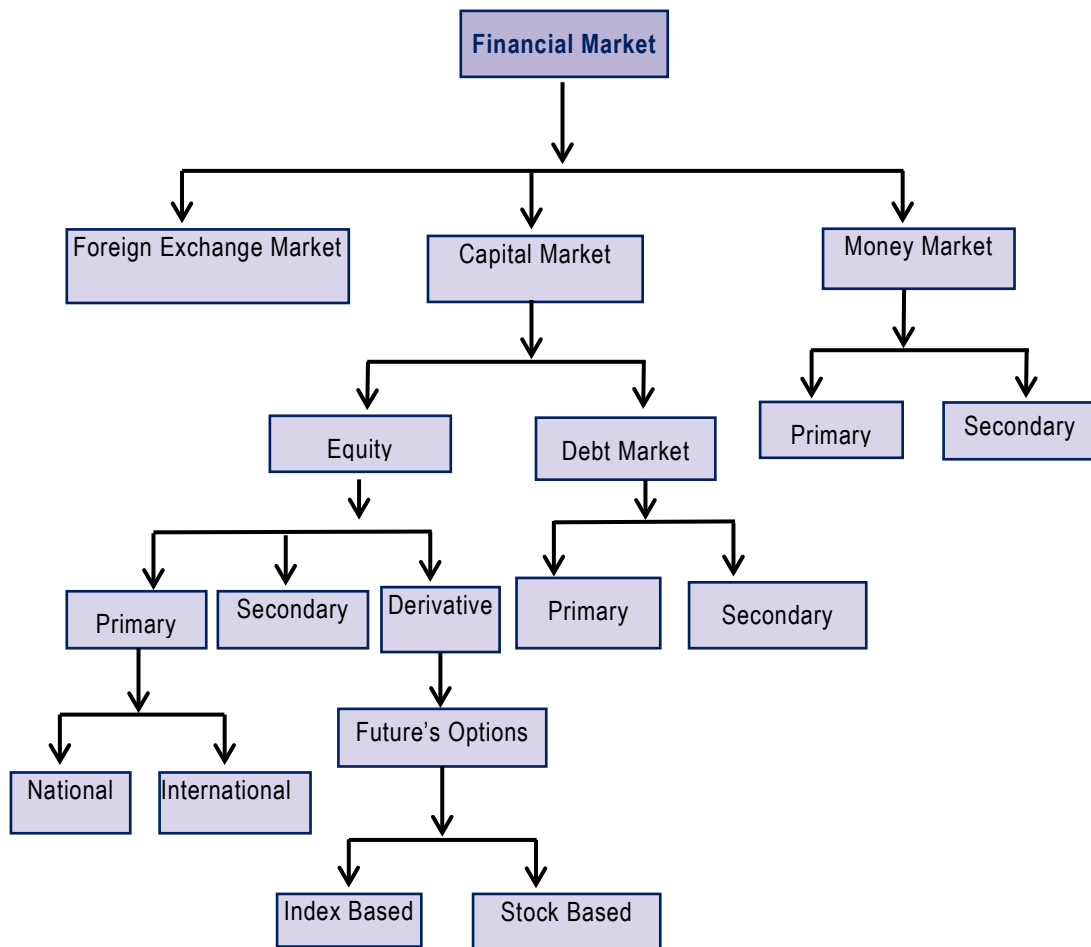
Share of different sectors in total assets of the Indian financial system



Source: RBI, SEBI, IRDA and PFRDA.

(ii) Financial Markets

The financial market is a market where trading of securities including equities, bonds, currencies and derivatives takes place. Financial market can be divided into money market and capital market. Money market is a market for short term securities having a maturity period of less than one year. Capital Market is a market for long term securities having a maturity period of more than one year. Further, capital market can be divided into primary market and secondary market. In primary market, securities (shares, bonds, debentures) are issued to the public for the first time. While in secondary market, trading (purchase and sale) takes place in those securities are already issued to the public.



Functions of Financial Markets:

The main functions of financial markets are enumerated as below:

- 1) To facilitate creation and allocation of credit and liquidity.
- 2) To serve as intermediaries for mobilization of savings.
- 3) To help in the process of balanced economic growth.
- 4) To provide financial convenience.
- 5) To provide information and facilitate transactions at low cost.
- 6) To cater to the various credits needs of the business organizations.

(iii) Financial Instruments

Financial instruments are those instruments which have a monetary value. These instruments can be classified into debt based securities and equity based securities. Equity based securities consist of equity share capital which is ownership based securities and represents risk capital. Debt based securities consists of bonds and debentures. Debenture is an acknowledgement of debt which has to be repaid in full in certain number of years mentioned at the time of issue of debenture itself. On the other hand, bonds are financial instruments issued by companies which are basically a financial contract between a company (borrower) and investors (lenders). Bonds are generally used by companies, municipalities, states and sovereign governments to raise money and finance a variety of projects and activities. Owners of bonds are debt holders or creditors of the issue.

Short-term debt-based financial instruments are issued for one year or less. Securities of this kind come in the form of T-bills and commercial paper. Long-term debt-based financial instruments are issued for more than one year. These are bonds, debentures and loans.

Characteristics of Financial Instruments

The important characteristics of financial instruments are enumerated as below:

- a) **Liquidity:** Financial instruments provide liquidity. These can be easily and quickly converted into cash.
- b) **Marketing:** Financial instruments facilitate easy trading on the market. They have a ready market.
- c) **Collateral value:** Financial instruments can be pledged for getting loans.
- d) **Transferability:** Financial instruments can be transferred from one person to another.

e) **Maturity period:** The maturity period of financial instruments may be short term, medium term or long term.

f) **Transaction cost:** Financial instruments involve buying and selling cost. The buying and selling costs are called transaction costs.

g) **Risk:** Financial instruments carry risk. Equity based instruments are riskier in comparison to debt based instruments because the payment of dividend is uncertain. A company may not declare dividend in a particular year. However, payment of principle or interest is more or less certain unless the company gets insolvent.

h) **Future trading:** Financial instruments facilitate future trading so as to cover risks arising out of price fluctuations, interest rate fluctuations etc.

(iv) Financial Services

Financial services are services which involves investment, lending, and management of money and assets. Financial services are needed for the following activities:

- (i) Borrowing and lending
- (ii) Investing
- (iii) Buying and selling securities
- (iv) Making and enabling payments and settlements
- (v) Managing risk

Liquidity is required for the good functioning of the financial system. Financial liquidity is enhanced through trading in securities. Liquidity is provided by brokers who assist the buyers and sellers of securities in arriving at a trade agreement. Also, market makers help in increasing liquidity by providing buy and sell quotes.

The producers of financial services are financial intermediaries or institutions such as banks, insurance companies, mutual funds and stock exchanges. These financial institutions provide financial services such as merchant banking, leasing, hire purchase, factoring and credit rating. Financial services rendered by financial institutions bridge the gap between lack of knowledge on the part of investors and latest trends in the financial instruments and markets. These financial services are essential for the creation of new business, expansion of existing industries and economic growth.

The various types of financial services are briefly explained as below:

(a) Investment Banking

Companies need cash in order to grow and expand their businesses; Investment banks sell

securities to public investors in order to raise the cash. These securities come in the form of stocks or bonds. Thus, Investment banks are essentially financial intermediaries, who assist their clients in raising capital either by underwriting their shares or bonds or by acting as an agent (merchant banker) in the issuance of securities.

(b) Credit Rating

Credit Rating means an assessment made from credit-risk evaluation, translated into a current opinion as on a specific date on the quality of a specific debt security issued or on obligation undertaken by an enterprise in terms of the ability and willingness of the obligator to meet principal and interest payments on the rated debt instrument in a timely manner.

Thus, Credit Rating is:

- (1) An expression of opinion of a rating agency.
- (2) The opinion is in regard to a debt instrument.
- (3) The opinion is as on a specific date.
- (4) The opinion is dependent on risk evaluation.
- (5) The opinion depends on the probability of interest and principal obligations being met timely.

Such opinions are relevant to investors due to the increase in the number of issues and in the presence of newer financial products viz. asset backed securities and credit derivatives.

(c) Consumer finance

Consumer credit provides short term/medium term loans to finance purchase of goods or services for personal use. There are four important sources of consumer finance viz manufacturers/sellers/dealers, finance companies, banks and credit card companies. In the past, banks provided finance to manufacturing organizations. The consumers borrowed money from the sellers/dealers directly. Finance companies too entered this arena while credit card entitles with the support from banks started operating with substantial success. Both nationalized and private sector banks have started marketing aggressively for a large slice of the market share in this consumer finance segment. Employers also provide loan facilities to salary earners as a part of welfare scheme for their employees. In big concerns, employees organize themselves into co-operative credit societies and funds raised by its members through periodical contributions are used as loan assistance at low rate of interest.

(d) Factoring

This concept has not been fully developed in our country and most of their work is done by

companies themselves. All units' particularly small or medium size units have to make considerable efforts to realize the sale proceeds without much success creating functional difficulties for such units.

Many a units under small-scale sector have become sick only because of delay/non-realisation of their dues from large units. Introduction of factoring services will, therefore, prove very beneficial for such units as it will free the units from hassles of collecting receivables to enable them to concentrate on product development and marketing.

(e) Housing Finance

The volume and growth rate across time periods in housing loans are viewed as one of the important barometers of measuring growth in an economy. The demand for Housing Finance comes from:

- 1) Salary earners and self-employed professionals with their basic need of a roof over their head.
- 2) Nonresidents having an eye on capital appreciation of the asset or with an eye to their possible resettlement in India for NRIs.

The supply of loans comes from:

- (a) LIC, National Housing Bank in the government sector.
- (b) Private Sector housing companies viz. HDFC, Commercial Banks etc.
- (c) Non Banking Finance Companies, Nidhis and Chit funds, Co-operative and Credit Societies, employers extending staff loans for housing, beside private money lenders.

(f) Asset Restructuring/Management Company

Asset reconstruction company's (ARC) first task is to manage and convert the sick companies or those companies whose NPA's rose to a significant level into profitable ones. But, the ARC's face the risk of suffering loss if the company they are trying to manage may land itself into insolvency. However, if properly managed, the ARC's may be able to recover them from financial distress, convert them into profitable ones and transfer them to worthy candidates. ARC's charge a commission or fee from the distressed company for their services.

Asset Management Companies (AMC's) pool large amount of funds from various source of investors and invest these pooled resources in diverse securities by paying out proportional returns to the investors. Simply put, they help their client to invest money and buy securities. They decide what to buy by relying on in-house research and data analytics. AMC's charges a small fee for this sort of work.

(g) Depository Services

Depository system is concerned with conversion of securities from physical to electronic form, settlement of trades in electronic segment, electronic transfer of ownership of shares and electronic custody of securities. All securities in the depositories are identical in all respects and are thus fungible. The ownership and transfer of securities take place by means of book entries, avoiding the risks associated with paper.

(h) Debit Cards

Debit cards are also known as cheque cards. A debit card is a plastic card that provides the cardholder electronic access to his or her bank account(s) at a financial institution. Debit cards look like credit cards or ATM (automated teller machine) cards, but operate like cash or a personal cheque. Debit cards are different from credit cards. While a credit card is to “pay later,” a debit card is to “pay now.” When one uses a debit card his money is immediately deducted from his cheque or savings account.

(i) Online Share Trading

Online stock trading is an internet based stock trading facility where investor can trade shares through a website without any manual intervention from the broker. It also provides investors with rich, interactive information in real time including market updates, investment research and robust analysis.

1.6 Functions of a Financial System

(i) Mobilization of savings. Savings are done by millions of people. But amount saved are of no use unless they are mobilized into financial assets, whether currency, bank deposits, post office savings deposits, life insurance policies, mutual funds, bonds or equity shares.

(ii) Allocations of savings. Amount of savings mobilized through millions of people will then be allocated among the needy sectors. Direct lending by the general public has been made possible through corporate bonds and equities. Besides, there are banks, insurance companies, and other financial institutions. They serve as financial intermediaries between the ultimate lender and the ultimate borrower. They mobilize savings of the lender by selling their own liabilities which are deposits, insurance premium amount etc. and make these funds available to needy borrowers at their own risk. So, many savers find the secondary securities (indirect lending) of financial institutions much more acceptable than the primary securities (direct lending) of all sorts of borrowers.

(iii) A financial system provides a payment system for the exchange of goods and

services. For exchange or sale of goods and services, payment in cash is the most preferred mode. However, large scale businesses deal mostly in credit transactions. After a certain date, payments are made either through cheque or online payment.

(iv) A financial system provides a mechanism for the pooling of funds to invest in large-scale enterprises. Large corporates raises funds through bonds, debentures and public deposits to invest in large scale business enterprises.

(v) Provide payment and settlement system. Banks provide this mechanism by means of a payment facility based upon cheques, promissory notes, credit and debit cards. The payment mechanism is now being increasingly made through electronic means. The clearing and settlement mechanism of the stock market is done through depositories and clearing corporations.

(vi) Monitor corporate performance. A financial system not only helps in selecting the projects to be funded but also motivates the various stakeholders of the financial system to monitor the performance of the investment. Financial markets and institutions help to monitor corporate performance and exert pressure on the corporates to continuously improve their performance.

(vii) Helps in risk reduction – The financial system helps in reduction of risk in the financial system by laying down rules for e.g. SEBI which lays down rules, regulations and guidelines from time to time for efficient and transparent conduct of operations in the capital market. Risk reduction is achieved by diversification of portfolios and screening of borrowers. Market participants also protect themselves from unexpected contingencies by buying insurance services. Risk is traded in the financial market through financial instruments such as derivatives. The derivatives shift risk from those who have it but don't want it to those who are willing to take it.

(viii) Provide price related information – Financial markets provide information which enables the investors to make an informed decision about whether to buy, sell or hold a financial asset. This information dissemination facilitates valuation of financial assets. Further, this process of valuation influences the market price of equity and debt instruments and guides the management as to whether their actions are consistent with the objective of wealth maximization of shareholders.

1.7 Key elements of a well-functioning Financial System

Key elements of a well-functioning financial system are explained as below:

(i) A strong legal and regulatory environment – Capital market is regulated by SEBI which

acts a watchdog of the securities market. This has been ensured through the passing of SEBI Act, Securities Contract Regulation Act and numerous SEBI rules, regulations and guidelines. Likewise money market and foreign exchange market is regulated by RBI and this has been ensured through various provisions of the RBI Act, Foreign Exchange Management Act etc. Thus, a strong legal system protects the rights and interests of investors and acts as a most important element of a sound financial system.

(ii) Stable money – Money is an important part of an economy. Frequent fluctuations and depreciations in the value of money lead to financial crises and restrict the economic growth.

(iii) Sound public finances and public debt management – Sound public finances means setting and controlling public expenditures and increase revenues to fund these expenditures efficiently. Public debt management is the process of establishing and executing a strategy for managing the government's debt in order to raise the required amount of funding. It also includes developing and maintaining an efficient market for government securities.

(iv) A central bank – A central bank supervises and regulates the operations of the banking system. It acts as a banker to the banks and government, manager of money market and foreign exchange market and also lender of the last resort. The monetary policy of the Central Bank is used to keep the pace of economic growth on a higher path.

(v) Sound banking system – A well-functioning financial system must have large variety of banks both in the private and public sector having both domestic and international operations with an ability to withstand adverse national and international events. They perform varied functions such as operating the payment and clearing system, and foreign exchange market. Banks also undertake credit risk analysis and assess the expected risk and return of a project before giving any loan for a proposed project.

(vi) Information System – All the participants in the financial system requires information at some stage or the other. Proper information disclosure practices form basis of a sound financial system for e.g. the corporates has to disclose their financial performance in the financial statements. Similarly, at the time of initial public offering, the companies have to disclose a host of information disclosing their financial health and efficiency.

(vii) Well functioning securities market – A securities market facilitates the issuance of both equity and debt. An efficient securities market helps in the deployment of funds raised through the capital market to the required sections of the economy, lowering the cost of capital for the firms, enhancing liquidity and attracting foreign investment.

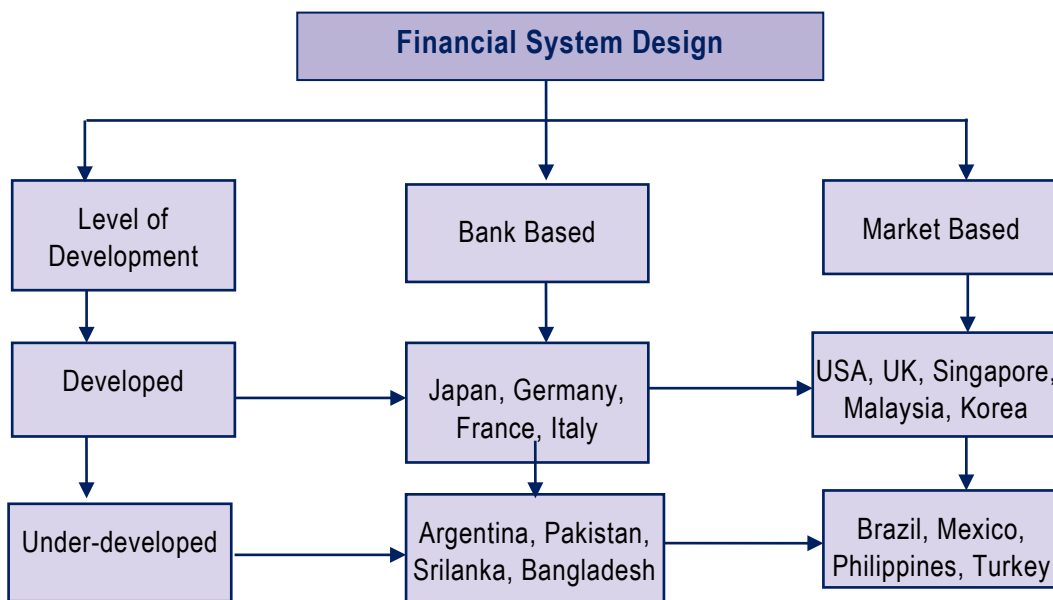
1.8 Financial System Design

A financial integration is a well-integrated chain of financial markets and institutions that provide

financial services. Different design of financial markets is found in different countries. Financial system design can be demarcated into **bank based** and **market based**.

The bank dominated system which is prevalent in Germany is one extreme where banks play a dominant role and stock market is not that relevant. On the other hand, there is market based system, which is prevalent in USA, where banks play a much lesser role and the economy is largely controlled by the financial markets.

Demirguc Kunt and Levine (1999) have provided explanations of bank based and market based financial systems. In bank based financial systems, banks play a pivotal role in mobilizing savings, allocating capital, overseeing the investment decisions of corporate managers, and providing risk-management facilities. In market based financial systems, the securities markets share centre stage with banks in mobilizing the society's savings for firms, exerting corporate control, and easing risk management.



Advantages of market based system

- (i) Stock markets facilitate diversification of securities to enable the investors to reduce risks.
- (ii) In furtherance of the above point, it can be reiterated that it helps the investors to reduce their risks.

(iii) Market based system provides an information system which enables investor to make an informed decision which is reflected in the stock prices, and in turn leads to efficient allocation of investment.

(iv) Another advantage of market based system is that they facilitate financing of new technologies.

Therefore, in case of emerging companies with significant financial and technological risks, a market based system is preferable.

Disadvantages of market based system

(i) Market based system is prone to instability as market may be fluctuating in turbulent times.

(ii) Consequently, investors are exposed to market risk.

(iii) There is a free rider problem.

Advantages of bank-based financial system

(i) Close relationship with parties.

(ii) Provide tailor made contracts.

(iii) Efficient risk sharing.

(iv) No free rider problem.

Disadvantages of bank-based financial system

(i) Retards innovation and growth as banks may have preference for low risk, low return projects.

(ii) Impedes competition and entry of new firms because banks may collude with business managers against investors.

Difference between bank based financial system and market based financial system

(a) In a market based financial system, the majority of the financial power is held by the stock market and the economy is dependent on how well or poorly the stock market is performing. On the other hand, in bank based financial system, the economy is dependent on how well or poorly the banking system is doing.

(b) In a market based system, banks are less dependent on interest from loans for their revenue enhancements and focuses on fee based services such as checking of accounts. However, in a bank based system, they focus their attention more on loans and are more dependent on

interest from loans for their revenue increase.

(c) In a market-based financial economy, the wealth is spread more unevenly while in a bank-based financial system, the economy's wealth is more evenly spread.

(d) Market based financial system constantly changes and each individual within the society has the opportunity to gain or lose on any given day. But, in bank based financial system only a few are given the opportunity to maximize their gain.

(e) In a market based financial system, laws are basically set forth and carried out by the government and are basically based on civil law rather than common law. Bank based financial system is prevalent where common law legal system is mostly there.

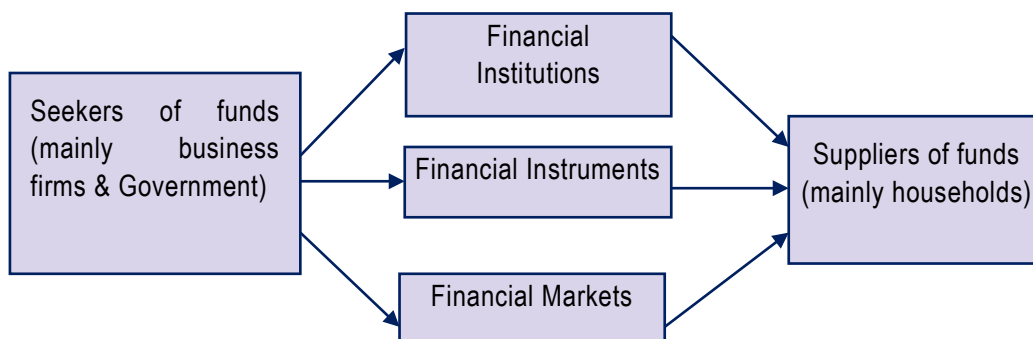


2. ROLE OF FINANCIAL MARKET IN ECONOMIC DEVELOPMENT

2.1 Contribution of various types of financial market in economic development

Efficient and sound financial market of a country plays an important role in the nation's economic development. The economic development of a country depends upon the mobilization of savings and the flow of these savings to the corporates. The corporates acquire funds by issuing securities in the financial market by influencing the investors to invest their savings or borrowing from financial institutions. The savings of individuals, corporate sector and government should be mobilized by the financial institution, through financial markets by creating financial instruments with the help of the watchful eyes of financial regulators.

Flow of funds from Savers to borrowers in financial market which contributes to economic development



The contribution of various types of financial markets in economic development has been discussed as below:

(i) Capital Market

Capital market has an important role in India's industrial growth. Capital market is the market where long term debt and equity funds are traded. Industries which require capital on a large scale may tap the capital market. Therefore, the capital market provides the much needed liquidity into the economy and it gives a big boost to the GDP of an economy as it serves as an effective source of allocation of capital to the Industry and Government.

The primary role of capital market is to transfer surplus funds to deficit sectors which are in dire need of money. The capital market performs the crucial function of facilitating capital formation in the economy. Capital market can be divided into primary market and secondary market. Primary market is utilized by companies for the purpose of setting up new businesses or for expanding or modernizing the existing business. Secondary market provides an opportunity to the company to raise the market price of their shares, thereby enabling them to attract more capital from investors and loans from banks. It also helps the shareholders to increase their wealth.

However, the contribution of **Medium and Small Scale (MSME)** in India's GDP cannot be denied. As per details provided by the Press Information Bureau dated 22nd July, 2014, the estimated contribution of manufacturing sector Micro, Small and Medium Enterprises (MSME) to GDP, during 2012-13, is approximately 7.04%. However, taking into account the contribution of services sector MSME, which is estimated at 30.50% during 2012-13, the share of MSME sector in GDP of the country, during 2012-13, is 37.54%. It has also been observed that MSME sector that provides the highest number of employment opportunities has been hit by severe capital crunch. So, this is an area where immediate measures are required so that necessary capital can be infused to provide much needed liquidity. This is urgent because unless the MSME sector will get the much needed capital they deserve, they cannot boost up their production. If production doesn't get increased, employment generation will not take place. Low employment generation will not raise the standard of living of the people. This will slow the rate of economic growth and development of an economy. The SME Exchange is a welcome move for the Small and Medium Scale Enterprises, but it is alone not enough to revive MSME.

(ii) Money Market

Money market is the market where short-term funds are traded. In simple term, it means that all the financial assets or instruments which can be easily converted into money are traded in this market. The short-term money requirement of the borrowers can be easily met with the

funds provided by the money market.

Money markets play a key role in banks' liquidity management and the monetary policy of RBI which are discussed as below:

(a) Banks' liquidity management

Banks have to maintain Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR). CRR is the reserve which the Banks have to keep with Reserve Bank of India (RBI). On the other hand, SLR is the amount which the banks have to keep with themselves. Banks are often evaluated on the basis of their liquidity.

SLR requirements help banks to do that. Whenever the RBI issues treasury bills on behalf of the Government, CRR and SLR requirements of banks are automatically met.

(b) Monetary policy

Monetary policy affects rates of interest, inflation and business cycle. Through the introduction of repos and reverse repos, the government adjusts the rate of interest, thus, reducing or increasing money supply by impacting inflation, thereby effecting changes in business cycles. Also, by introducing treasury bills and other money market instruments, it affects money supply and consequently inflation and business cycles.

In normal times, money markets are among the most liquid in the financial sector. By providing the appropriate instruments for liquidity trading, the money market allows the refinancing of short and medium-term positions and facilitates the mitigation of one's business liquidity risk with the help of commercial papers, commercial bills and certificate of deposits.

(iii) Foreign Exchange Market

Foreign exchange earned through foreign direct investment in India can be used to remove the poverty and for other productive purposes. Inflow of foreign exchange increases the scale of production and national income of the country. With the rise in the demand of domestic goods, resources of a country are fully utilized and it helps in reducing the unemployment of a country.

Foreign exchange (forex) markets provide traders with a lot of flexibility. This is because there is no restriction on the amount of money that can be used for trading. Forex markets provide traders with a wide variety of trading options. They have the choice of entering into spot trade or they could enter into a future agreement. Futures agreements are also available in different sizes and with different maturities to meet the needs of the Forex traders. Therefore, Forex market provides an option for every budget and every investor with a different appetite for risk taking. Further, the Forex market is transparent in comparison to other financial market as it is huge in size and operates across several

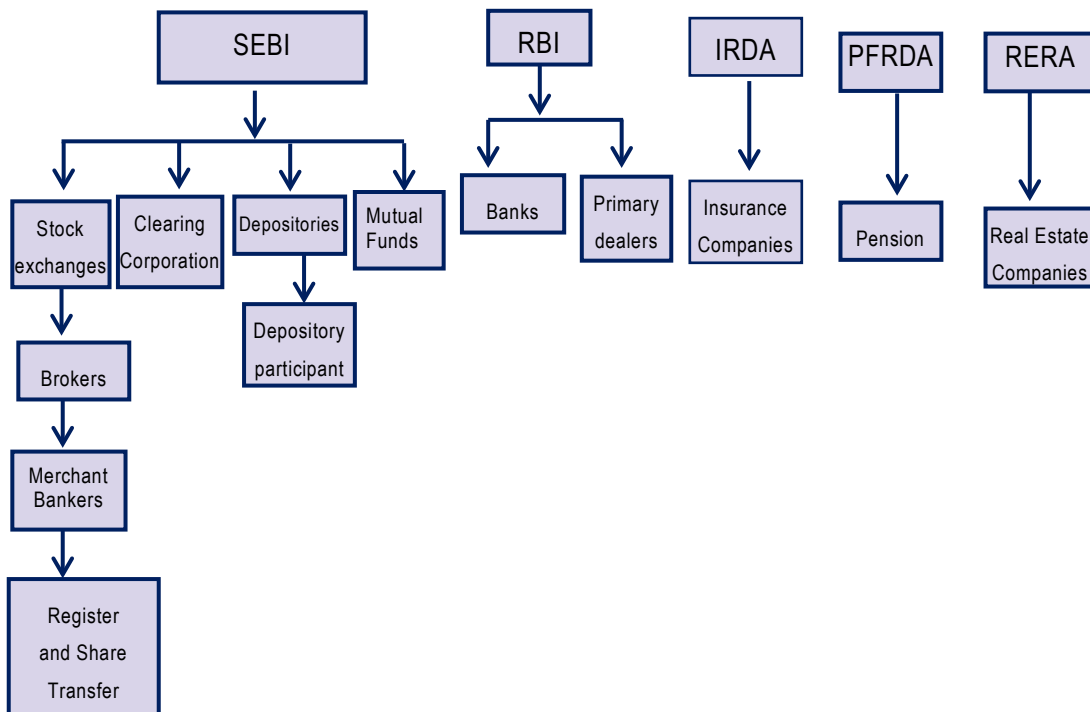
time zones. Information regarding Forex markets is easily available. Also, no country or Central Bank has the ability to single handedly corner the market or rig prices for an extended period of time.

(iv) Derivative Market

The derivatives market is the financial market for derivatives i.e. financial instruments like futures and options, which are derived from other forms of assets. Since all transactions related to derivatives take place in future, it provides individuals with better opportunities because an individual who want to short (sell) some stock for long time can do it only in futures or options hence the biggest benefit of this is that it gives numerous options to an investor or trader to execute all sorts of strategies.

2.2 Regulators in Financial Market

Regulatory structure of Indian Financial System



2.2.1 Securities and Exchange Board of India (SEBI)

SEBI was born in 1992. The basic objective was to protect the interest of investors in securities and promotes the development of securities market. The important objectives of SEBI are:

- i) Protect the interest of investors in securities.
- ii) Promotes the development of securities market.
- iii) Regulating the securities market.

Functions of SEBI as per SEBI Act, 1992

- (a) regulating the business in stock exchanges and any other securities markets;
- (b) registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner;
- [(ba) registering and regulating the working of the depositories, [participants,] custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as the Board may, by notification, specify in this behalf;]
- (c) registering and regulating the working of [venture capital funds and collective investment schemes], including mutual funds;
- (d) promoting and regulating self-regulatory organisations;
- (e) prohibiting fraudulent and unfair trade practices relating to securities markets;
- (f) promoting investors' education and training of intermediaries of securities markets;
- (g) prohibiting insider trading in securities;
- (h) regulating substantial acquisition of shares and take-over of companies;
- (i) calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds, other persons associated with the securities market intermediaries and self-regulatory organizations in the securities market;
- (ia) calling for information and record from any bank or any other authority or board or corporation established or constituted by or under any Central, State or Provincial Act in respect of any transaction in securities which is under investigation or inquiry by the Board;
- (j) performing such functions and exercising such powers under the provisions of the Securities Contracts (Regulation) Act, 1956(42 of 1956), as may be delegated to it by the Central Government;
- (k) levying fees or other charges for carrying out the purposes of this section;

- (l) conducting research for the above purposes;
- (la) calling from or furnishing to any such agencies, as may be specified by the Board, such information as may be considered necessary by it for the efficient discharge of its functions;
- (m) performing such other functions as may be prescribed.

2.2.2 Reserve Bank of India (RBI)

The Reserve Bank of India was established in 1935 with the provision of Reserve Bank of India Act, 1934. Though privately owned initially, in 1949 it was nationalized and since then fully owned by Government of India (GoI). The preamble of the Reserve Bank of India describes its main functions as to regulate the issue of Bank Notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage.

As per the RBI Act, 1934, RBI performs three types of functions:

(i) Banking Functions -

(a) Issuer of Bank Notes - Under section 22 of the Reserve Bank of India Act, the bank has the sole right to issue bank notes of all denominations. The distribution of one rupee notes and coins and small coins all over the country is undertaken by the Reserve Bank as agent of the Government.

(b) To act as government banker, agent and adviser - The second important function of the Reserve Bank of India is to act as Government banker, agent and adviser. The Reserve Bank is agent of Central Government and of all State Governments in India except the State of Jammu and Kashmir.

(c) Bankers' Bank and Lender of the Last Resort – The commercial banks always look up to RBI in case of any need for funds. Therefore, they are called bankers' bank and lender of the last resort.

(d) Controller of Credit - The Reserve Bank of India is the controller of credit i.e. it has the power to influence the volume of credit created by banks in India. It can do so through changing the Bank rate or through open market operations. RBI is also the selective controller of credit. It can direct the banks not to lend to certain people or group of people on the basis of certain types of securities. RBI also has the power to control the money market in India. Further, on every weekly Friday which is called the reporting Friday, the commercial banks have to report to the RBI that they are complying with CRR (presently 4%) and SLR (presently 20.5%) requirements.

(e) Custodian of Foreign Reserve - The foreign exchange regulations under the law required that all foreign exchange receipts whether on account of export earnings, investment earnings, or capital receipts, whether on private account or on government account, must be sold to the RBI either directly or through authorized dealers (mostly commercial banks). This resulted in centralization of country's foreign exchange reserves with the RBI and facilitated planned utilization of these reserves, because all

payments in foreign exchange were also controlled by the authorities.

(ii) Supervisory Functions –

The Reserve Bank Act, 1934, and the Banking Regulation Act, 1949 have given the RBI wide powers of supervision and control over commercial and co-operative banks, relating to licensing and establishments, branch expansion, liquidity of their assets, management and methods of working, amalgamation, reconstruction and liquidation. Further, the RBI is authorized to carry out periodical inspection of the banks and to call for returns and necessary information from them. Therefore, the supervisory functions of RBI have forced the banks to do their job on sound lines and to improve the methods of their operation.

(iii) Promotional Functions –

The Central Bank (RBI) now performs a variety of developmental and promotional functions, which, at one time, were regarded as outside the normal scope of central banking. So, the Reserve Bank was asked to promote banking habit amongst the people. People are encouraged to open Jan Dhan Account in urban and rural areas on the basis of their Aadhar Card. Now, people are asked to resort to online banking as the Government is promoting cashless economy. Banks are also gearing up to this challenge as they will need the required infrastructure to enable the customers to transact through online banking only. The reason is that recent trends indicate that transactions through ATM will reduce in the future.

Earlier, the Reserve Bank has helped in the setting up of the Industrial Finance Corporation of India and the State Financial Corporations; it set up the Deposit Insurance Corporation in 1962, the Unit Trust of India in 1964, the Industrial Development Bank of India also in 1964, the Agricultural Refinance Corporation of India in 1963 and the Industrial Reconstruction Corporation of India in 1972.

It also helps in the setting up of various sector specific development financial institutions, for instance, NABARD which provides agricultural credit and also supervises Regional Rural Banks (RRB's). Further, EXIM Bank was created which provides necessary credit to exporters and importers.

2.2.3 Insurance Regulatory and Development Authority of India (IRDAI)

IRDA Act was passed in 1999. The main aim of the Insurance Regulatory and Development Authority of India is to protect the interest of holders of Insurance policies to regulate, promote and ensure orderly growth of Insurance industry & for matters connected therewith or incidental thereto. Under this Act, Controller of Insurance under Insurance Act 1938 was replaced by newly established authority called Insurance Regulatory and Development Authority (IRDA).

Features of Authority:

- (i) The authority consists of chairman, whole time members & part time members and they act as a group of members and work jointly.
- (ii) The authority has a perpetual succession. In case, if any member resigns or die, the authority still continues to work.
- (iii) The authority has a common seal with power to enter into a contract by affixing stamp on the documents.
- (iv) The authority can sue or be sued means the authority can file a case against any person or organization and vice versa.

Duties, Powers & Functions of Authority:

- (i) Subject to the provisions of this Act and any other law for the time being in force, the Authority shall have the duty to regulate, promote and ensure orderly growth of the insurance business and re-insurance business.
- (ii) Without prejudice to the generality of the provisions contained in sub-section (1), the powers and functions of the Authority shall include, -
 - (a) issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration;
 - (b) protection of the interests of the policy holders in matters concerning assigning of policy, nomination by policy holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;
 - (c) specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents;
 - (d) specifying the code of conduct for surveyors and loss assessors;
 - (e) promoting efficiency in the conduct of insurance business;
 - (f) promoting and regulating professional organisations connected with the insurance and re-insurance business;
 - (g) levying fees and other charges for carrying out the purposes of this Act;
 - (h) calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organizations connected with the insurance business;

- (i) control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938);
- (j) specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;
- (k) regulating investment of funds by insurance companies;
- (l) regulating maintenance of margin of solvency;
- (m) adjudication of disputes between insurers and intermediaries or insurance intermediaries;
- (n) supervising the functioning of the Tariff Advisory Committee;
- (o) specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organisations referred to in clause (f);
- (p) specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and [Source : www.irdai.gov.in]

Importance of Insurance Regulatory and Development Authority (IRDA)

(i) Regulation of Insurance Sector

IRDA has a significant effect on the overall regulation of Indian Insurance Sector. In order to keep the proper protection of the policy holder's interests, Insurance Regulatory and Development Authority (IRDA) closely observe the different activities of insurance sector in India.

(ii) Protection of Policyholders Interests

The core objective or purpose of the Insurance Regulatory and Development Authority is to protect the interests of policyholders and IRDA is doing that with aplomb.

(iii) Awareness to Insurance

In order to increase the awareness of insurance in the society, IRDA is trying to convince the prospective investors about the transparency of the system and the effort being put by the regulator to put this into practice.

(iv) Insurance Market

Insurance sector has grown leap and bounds due to the concerted efforts of Insurance Regulatory and Development Authority with respect to marketing of insurance products, competition & customer awareness.

(v) Development of Insurance Product

Insurance Regulatory and Development Authority (IRDA) has brought a revolution in the development of insurance products. The development of ULIPs (Unit-Linked Insurance Plans) is the result of privatization of the insurance sector.

(vi) Competition in the Insurance Sector

After the advent of privatization in the insurance sector by inviting private players, competition in the insurance sector has increased significantly leading to comparatively cheaper services and greater customer satisfaction.

(vii) Saving and Investment of Individual

Insurance Regulatory and Development Authority has made insurance a popular & profitable mode of investment and inculcate saving habits among various sections of the society.

(viii) Government Responsibility

Insurance Regulatory and Development Authority (IRDA) has make it sure that uniformity in the insurance sector is being ensured by helping in constant increase in the number of insurers, increasing competition, number of diversified products and diversification in the activities of the insurers.

(ix) Banks and Post Offices

Insurance sector is now giving security against any kind of uncertainty or risk, so the insurance sector has now become a popular medium for savings & investments and is gradually diverting the flow of funds from banks & post offices to insurance industry.

(x) Individual Life's

Insurance Regulatory and Development Authority has helped in developing an understanding of insurance by putting across a great impression over the life of a common man of the society.

(xi) Stock Market

Private players in the insurance have developed ULIPs (Unit-Linked Insurance plans) in order to attract more customers. ULIP is a byproduct of modern insurance market. Therefore, insurance products have made it simple for the companies to raise funds and have also attracted various sections of the society to invest in the stock market indirectly.

(xii) Indian Economy

Insurance Regulatory and Development Authority has an impact over the economic development of the country because money invested by investors or individuals in various types of insurance products has

channelized the funds of a country for a non-economic activity to economic activity & has made available to the governments of a country in order to implement the various developmental activities in the country.

2.2.4 Pension Fund Regulatory and Development Authority (PFRDA)

The aim of PFRDA is to be a model Regulator for promotion and development of an organized pension system to serve the old age income needs of people on a sustainable basis. Pension systems throughout the world have been under close scrutiny over the last couple of decades. Numerous reforms have been carried out to tackle the sustainability and adequacy of pension arrangements in the face of the rising global demographic challenge.

For the next two decades, India has the potential to reap demographic benefits. The country's population pyramid is expected to "bulge" across the 15–64 age brackets over the next decade. Around 64% of India's population is expected to be in the age bracket of 15–59 years by 2026, with 13% of the total aged above 60 years. However, India's demographic dividend is expected to level off around 2040. In 2050, the old age dependency ratio is likely to increase to 18.7 % of the total population from 8.6 % in 2011. With the shift to nuclear families, intergenerational support cannot be the sole source of old age security. So, it is necessary to be prepared for the future challenge of old age income security of our people in their old age.

The pension landscape in India can be broadly categorized under four pillars. Pillar 0 constitutes means tested pension schemes like IGNOAPS, Annapurna etc. Pillar - 1 constitutes tax financed, defined benefit pension system under which the employees of central and state governments and their autonomous bodies, joined prior to January 1, 2004 or the date of adoption of the respective state governments, respectively are covered. While Pillar 2 covers mandatory defined contribution retirement schemes like NPS (for government subscribers), EPF etc., Pillar 3 covers voluntary subscribers of NPS like corporate subscribers and subscribers from unorganised sector.

During FY 2014-15, the coverage under mandatory NPS, comprising central and state government employees has witnessed a decent growth of 23.65% with total number of government subscribers at around 41.42 lakh at end of March 2015. 488 Central Autonomous bodies and 438 State Autonomous Bodies have joined NPS. The coverage under voluntary NPS has witnessed an impressive growth of 45.93 % taking count of private and unorganised sector subscribers to around 46 lakh at the end of March 2015.

The major challenge faced by PFRDA is to extend pension coverage to the people from informal sector characterized by low financial literacy, financial affordability, and financial savings.

Normally, saving for retirement requires regular disciplined contributions, preserved until retirement.

The incomes of workers in the informal sector are frequently seasonal and volatile which prevents regular periodic contributions. Also, households living at or below subsistence are unlikely to be able to afford to pay for pension for long term.

To address this, it is important to build trust and confidence of people in the institutional framework in which the retirement savings are made, especially, in cases where informal sector workers are dealing with them for the first time and do not have an employer to negotiate arrangements on their behalf. Also some form of incentive needs to be given to the prospective subscribers to part with their money for a long time.

Towards this end a new scheme, Atal Pension Yojana (APY) has been launched by the government with effect from June 1, 2015 which provides the strategic direction for shaping the pension landscape in the country to convert the society from “pension less” to “pensioned” one in the largely uncovered informal sector. As pension involves a long term commitment, there is a need to create awareness and financial literacy to encourage informal sector worker to save for their retirement.

Under APY, the Central Government co-contributes 50% of the subscriber's contribution or Rs. 1000 per annum, whichever is lower, to each eligible subscriber account, for a period of 5 years, i.e., from 2015-16 to 2019-20, who join the NPS before December 31, 2015 and who are not income tax payers. State Governments can also co-contribute under APY to their underlying workers like Anganwadi, ASHA, and Construction Labour etc. to encourage the subscribers to join the scheme and secure their old age. The subscribers of APY would receive minimum pension of Rs. 1000 to Rs. 5000 per month, at the age of 60 years, depending on their contributions, which itself would vary depending on the age of joining the APY. APY has low costs and has access in rural areas via existing networks of post offices and banks.

Additionally, there is flexibility to contribute on monthly, quarterly and half yearly basis. Subscriber of APY are updated periodically with the information regarding activation of PRAN, balance in the account, contribution credits etc. by way of SMS alerts. The subscribers have the option to change the non-financial details like nominee's name, address, phone number etc. whenever required.

2.2.4.1 What is a National Pension Scheme (NPS)?

NPS is an easily accessible, low cost, tax-efficient, flexible and portable retirement savings account. Under the NPS, the individual contributes to his retirement account and also his employer can also co-contribute for the social security/welfare of the individual. NPS is designed on Defined contribution basis wherein the subscriber contributes to his account, there is no defined benefit that would be available at the time of exit from the system and the accumulated wealth depends on the contributions made and the income generated from investment of such wealth. The greater the value of the contributions made, the greater the investments achieved, the longer the term over which the fund

accumulates and the lower the charges deducted, the larger would be the eventual benefit of the accumulated pension wealth likely to be. This can be explained with the help of the following equation :

Contributions + Investment Growth – Charges = Accumulated Pension Wealth (Individual contribution as well as co-contribution from Employers)

2.2.4.2 Who can Join NPS?

Any citizen of India, whether resident or non-resident, subject to the following conditions: Individuals who are aged between 18 – 60 years as on the date of submission of his/her application to the POP/ POP-SP. The citizens can join NPS either as individuals or as an employee-employer group(s) (corporates) subject to submission of all required information and Know your customer (KYC) documentation. After attaining 60 years of age, you will not be permitted to make further contributions to the NPS accounts.

2.2.4.3 How are the funds contributed by the subscribers managed under NPS?

The funds contributed by the Subscribers are invested by the PFRDA registered Pension Fund Managers (PFM's) as per the investment guidelines provided by PFRDA. The investment guidelines are framed in such a manner that there is minimal impact on the subscribers contributions even if there is a market downturn by a judicious mix of investment instruments like Government securities, corporate bonds and equities. At present there are 8 Pension Fund Managers (PFM's) who manage the subscriber funds at the option of the subscriber. At present, Subscriber has option to select any one of the following 8 pension funds:

- ICICI Prudential Pension Fund
- LIC Pension Fund
- Kotak Mahindra Pension Fund
- Reliance Capital Pension Fund
- SBI Pension Fund
- UTI Retirement Solutions Pension Fund LIC Pension Fund
- HDFC Pension Management Company
- DSP Blackrock Pension Fund Managers. Since registration of PFMs is an ongoing process, this list will be updated from time to time.

2.2.4.4 What are the features of the retirement account provided under NPS?

The following are the most prominent features of the retirement account under NPS:

- Every individual subscriber is issued a Permanent Retirement Account Number (PRAN) card and has a 12 digit unique number. In case of the card being lost or stolen, the same can be reprinted with additional charges.
- Under NPS account, two sub-accounts – Tier I & II are provided. Tier I account is mandatory and the subscriber has option to opt for Tier II account opening and operation. The following are the salient features of these sub-accounts:
 - (i) Tier-I account: This is a non-withdrawable retirement account which can be withdrawn only upon meeting the exit conditions prescribed under NPS.
 - (ii) Tier-II account: This is a voluntary savings facility available as an add-on to any Tier-1 account holder. Subscribers will be free to withdraw their savings from this account whenever they wish.

Source: Chairman's speech and FAQ's - <http://www.pfrda.org.in>

2.2.5 Real Estate Regulatory Authority (RERA)

India has a vast population with needs regarding food, house and jobs on an ever-increase mode. The housing among these fields is one of the major ones. Thousands of people have grown to be rich and as many of them have made loss in real estate business. It is the one of the leading revenue generators for the government. Even though it has such strong presence in the country, it never had a regulating body. Due to the failure of the government to observe this, many people have become the victims of some scheming people doing the real estate business. The buyers who come from a middle-class background have time and again fallen prey to such petty real estate developers. There was a growing need to bring a transparent government body which can check the developers.

Finally, the government delivered by making an authority known as RERA which stands for Real Estate Regulatory Authority. It was passed in March 2016 by the parliament. This promises to bring a justice to the buyer through making strict policies that have to be fulfilled by the developers to sell their projects. The major problem that real estate in India is facing is that of the delayed possession given to the home seeker by the rich and the cunning builders. Thus, RERA will help people by bringing in a high level of transparency and discipline that these builders must have to follow.

Following are some of the risks that people face through developers:

- Selling of flats multiple times to different parties.
- Delay in giving possession to the buyer which happens due to various reasons and malpractices such as funding crisis, demanding additional charges in the name of facilities, reducing carpet area, changing the plans of the societies etc.

- The contracts made are one-sided in the favour of the developer, for example, a penalty of a massive 21% if one delay's the payment even by a day.

Apart from these risks, the buyer has to unwillingly become a part of a major tussle between the developers and the government relating to the approval of the projects. Many a time, the builder takes the money from a buyer and then his project ceases at half completion due to not completing some paperwork or not getting prior approvals with the government. Thus, in some way or the other, the government also becomes a part of this deceiving process as they start the approval process after the builder markets his project leading to many problems.

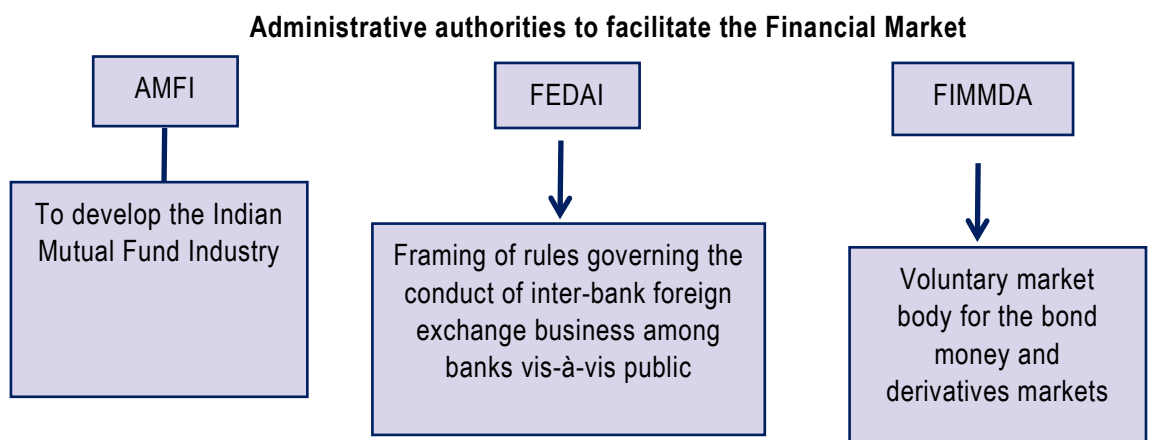
The laws under RERA are still in the early days of development but one thing is for sure that there will be a huge relief for the buyers regarding developer-specific risk. The mechanism of RERA will be made such that it provides a common ground for both the buyers as well as the developers. Transparency is the key point regarding the rules under RERA as the government wants that every aspect of information that the general public should know should be made available on an informational portal.

The regulatory risk will also be laid upon the developer as he will have to pay compensation if any mishap happen while giving the possession of a unit. All the builders will have to register themselves under RERA which will see a low risk in the property business.

However, even though RERA will bring a new light for the people affected due to the immoral practices of builders, it is still not certain whether the price will go up in the coming years.

Source : <http://www.merarera.com>

2.3 Administrative authorities to facilitate the Financial Market



2.3.1 Association of Mutual funds of India (AMFI)

The Association of Mutual Funds in India (AMFI) is dedicated to developing the Indian Mutual Fund Industry on professional, healthy and ethical lines and to enhance and maintain standards in all areas with a view to protecting and promoting the interests of mutual funds and their unit holders.

AMFI, the association of SEBI registered mutual funds in India of all the registered Asset Management Companies, was incorporated on August 22, 1995, as a non-profit organization. As of now, all the 42 Asset Management Companies that are registered with SEBI are its members.

2.3.1.1 Objectives of AMFI

- (i) To define and maintain high professional and ethical standards in all areas of operation of mutual fund industry.
- (ii) To recommend and promote best business practices and code of conduct to be followed by members and others engaged in the activities of mutual fund and asset management including agencies connected or involved in the field of capital markets and financial services.
- (iii) To interact with the Securities and Exchange Board of India (SEBI) and to represent to SEBI on all matters concerning the mutual fund industry.
- (iv) To represent to the Government, Reserve Bank of India and other bodies on all matters relating to the Mutual Fund Industry.
- (v) To undertake nationwide investor awareness programme so as to promote proper understanding of the concept and working of mutual funds.
- (vi) To disseminate information on Mutual Fund Industry and to undertake studies and research directly and/or in association with other bodies.
- (vii) To regulate conduct of distributors including disciplinary actions (cancellation of ARN) for violations of Code of Conduct.
- (viii) To protect the interest of investors/unit holders.

2.3.1.2 The AMFI Code of Ethics

One of the objects of the Association of Mutual Funds in India (AMFI) is to promote the investors' interest by defining and maintaining high ethical and professional standards in the mutual fund industry. In pursuance of this objective, AMFI had constituted a Committee under the Chairmanship of Shri A. P. Pradhan with Shri S. V. Joshi, Shri C. G. Parekh and Shri M. Laxman Kumar as members. This Committee, working in close co-operation with Price Waterhouse-LLP under the FIRE Project of USAID, has drafted the Code, which has been approved and recommended by the Board of AMFI for implementation by its members.

The AMFI Code of Ethics, “The ACE” for short, sets out the standards of good practices to be followed by the Asset Management Companies in their operations and in their dealings with investors, intermediaries and the public. SEBI (Mutual Funds) Regulation 1996 requires all Asset Management Companies and Trustees to abide by the Code of conduct as specified in the Fifth Schedule to the Regulation. The AMFI Code has been drawn up to supplement that schedule, to encourage standards higher than those prescribed by the Regulations for the benefit of investors in the mutual fund industry.

[Source: <http://www.amfiindia.com>]

2.3.2 Foreign Exchange Dealers Association of India (FEDAI)

Foreign Exchange Dealers Association of India (FEDAI) was set up in 1958 as an Association of banks dealing in foreign exchange (forex) in India (typically called Authorised Dealers - ADs) as a self-regulatory body and is incorporated under Section 25 of The Companies Act, 1956. Its major activities include framing of rules governing the conduct of inter-bank foreign exchange business among banks vis-à-vis public and liaison with RBI for reforms and development of forex market.

Functions:

Presently, some of the functions of FEDAI are as follows:

- (i) Guidelines and Rules for Forex Business.
- (ii) Training of Bank Personnel in the areas of Foreign Exchange Business.
- (iii) Accreditation of Forex Brokers.
- (iv) Advising/Assisting member banks in settling issues/matters in their dealings.
- (v) Represent member banks on Government/Reserve Bank of India/Other Bodies.
- (vi) Announcement of daily and periodical rates to member banks.

Due to continuing integration of the global financial markets and increased pace of de-regulation, the role of self-regulatory organizations like FEDAI has also transformed. In such an environment, FEDAI plays a catalytic role for smooth functioning of the markets through closer co-ordination with the RBI, other organizations like FIMMDA, the Forex Association of India and various market participants. FEDAI also maximizes the benefits derived from synergies of member banks through innovation in areas like new customized products, bench marking against international standards on accounting, market practices, risk management systems, etc.

[Source: www.fedai.org.in]

2.3.3 Fixed Income Money Market and Derivative Association of India (FIMMDA)

The Fixed Income Money Market and Derivatives Association of India (FIMMDA), an association of Scheduled Commercial Banks, Public Financial Institutions, Primary Dealers and Insurance Companies was incorporated as a Company under section 25 of the Companies Act, 1956 on June 3rd, 1998. FIMMDA is a voluntary market body for the bond, money and derivatives markets.

FIMMDA has members representing all major institutional segments of the market. The membership includes Nationalized Banks such as State Bank of India, its associate banks and other nationalized banks; Private sector banks such as ICICI Bank, HDFC Bank, IDBI Bank; Foreign Banks such as Bank of America, ABN Amro, Citibank, Financial institutions such as IDFC, EXIM Bank, NABARD, Insurance Companies like Life Insurance Corporation of India (LIC), ICICI Prudential Life Insurance Company, Birla Sun Life Insurance Company and all Primary Dealers.

Role of FIMMDA

- Functions as the principal interface with Regulators (like Reserve Bank of India, Securities Exchange Board of India, Ministry of Finance - Government of India, International Monetary Fund, World Bank)
- Mandated by the Reserve Bank of India for valuation of Government Bonds, Corporate Bonds and Securitised Papers for valuation of investment portfolios of Banks and Primary Dealers.
- Undertakes developmental activities such as introduction of benchmarks and new products (e.g. Mumbai Inter-bank Offered Rate, Commercial Papers, Securitised Asset, and Overnight Indexed Swaps).
- Suggests Legal and Regulatory framework for the development of new products.
- Training and Development Support to the Debt & Derivatives Market.
- Standardisation of market practices.

[Source: www.fimmda.org]

 TEST YOUR KNOWLEDGE**Theoretical Questions**

1. Explain the important characteristics of Financial Instruments.
2. Explain various types of Financial Services.
3. What are the key elements of a well-functioning of a Financial System.
4. Explain the various banking functions of RBI.
5. Explain the importance of IRDA.

Answers to Theoretical Questions

1. Please refer paragraph 1.5
2. Please refer paragraph 1.5
3. Please refer paragraph 1.7
4. Please refer paragraph 2.2.2
5. Please refer paragraph 2.2.3