An Overview of Indian Financial System

An Introduction

What is Finance?

What is a Financial System?

What are the components of Indian financial System?

What is a Financial Asset?

What is a Financial Market?

Who is a Financial Intermediary

Who is a Regulator? What is his Role in a Financial System?

Finance

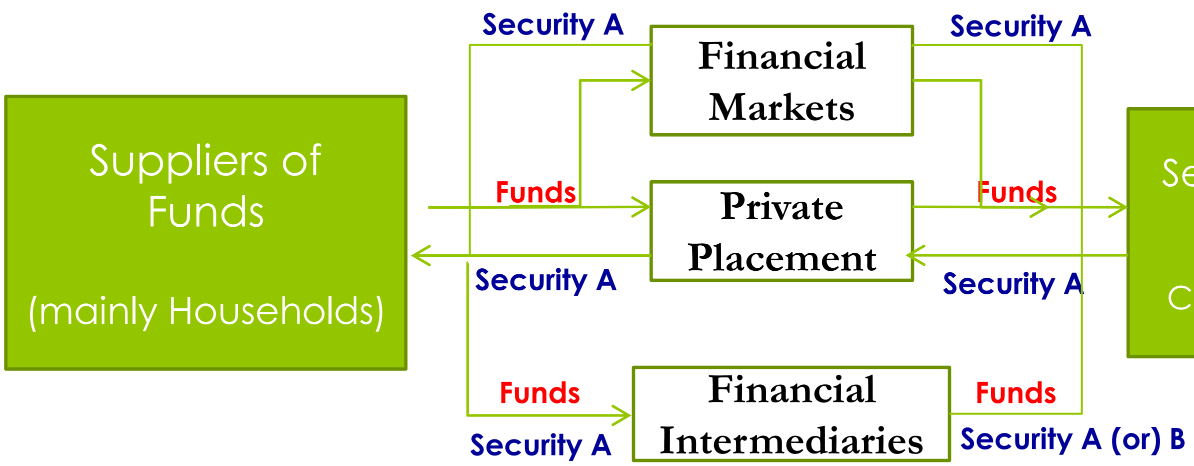
The term **"finance"** in our simple understanding it is perceived as equivalent to 'Money'

But finance exactly is not money, it is the source of providing funds for a particular activity.

Financial System – An Introduction

A financial system **functions as an 'intermediary' and facilitates the flow of funds** from the areas of surplus to the areas of deficit.

A Financial System is a composition of various institutions, markets, regulations and laws, practices, money manager, analysts, transactions and claims and liabilities.



Indian financial system consists of **financial markets, financial instruments and financial intermediaries.**

Sourcing of Funds

The following are the sources of funds -

- **Rights Issue**
- **Private Placement**
- **Public Issue**

'Financial Market' can be defined as the market in which **Financial Assets** are created or transferred.

Financial Assets or Financial Securities

- **R**epresents a claim to the payment of a sum of money
- **S**ometime in the future
- **A**nd /or periodic payment in the form of interest or dividend.

Financial Markets

Financial Markets

Capital Markets

The capital market is designed to finance the long-term investments.

The transactions taking place in this market will be for periods over a year.

Money Markets

The money market is a wholesale debt market for low-risk, highly-liquid, short-term instrument.

Funds are available in this market for periods ranging from a single day up to a year.

This market is dominated mostly by government, banks and financial institutions.

CAPITAL MARKET INSTRUMENTS

The capital market generally consists of the following long term period (more than one year) financial instruments -

EQUITY INSTRUMENTS - Equity shares, preference shares, convertible preference shares, non-convertible preference shares etc.

DEBT INSTRUMENTS - Debentures, zero coupon bonds, deep discount bonds etc.

HYBRID INSTRUMENTS - Hybrid instruments have both the features of equity and debenture. This kind of instruments is called as hybrid instruments. Examples are convertible debentures, CCDS, warrants etc.

MONEY MARKET INSTRUMENTS

The money market can be defined as a market for short-term money and financial assets that are near substitutes for money.

The term short-term means generally a period up to one year

Near substitutes to money is used to denote any financial asset which can be quickly converted into money with minimum transaction cost.

Some of the important money market instruments are

Call/Notice Money | Treasury Bills| Term Money | Certificate of Deposit |Commercial Papers

Financial Markets

Primary Markets	Secondary Markets
When companies need financial resources for its expansion, they borrow money from investors through issue of securities.	The place where such securities are traded by these investors is known as the secondary market.
Securities issued a) Preference Shares / Equity Shares/ Debentures	Securities like Preference Shares and Debentures cannot be traded in the secondary market.
Equity shares is issued by the under writers and merchant bankers on behalf of the company.	Equity shares are tradable through a private broker or a brokerage house.
People who apply for these securities are: a) HNIs/ Retail investors/ Employees/ Financial Institutions/ Mutual Fund/ Banks	Securities that are traded are traded by the retail investors.
One time activity by the company.	Helps in mobilizing the funds for the investors in the short run.

- **Meaning**
- **Financial Instruments**
- **Participants**
- **Institutions**
- **Risk Factor**
- **Liquidity**
- **Purpose**
- **Time Horizon**
- **Purpose**
- **Returns on Investment**

Market Intermediaries

Financial & Information intermediaries serve the purpose of a **proper channel** within the financial system to ensure the transfer of **financial assets and relevant information** takes place properly.

Fund Based Intermediaries

These Intermediaries collect/receive money from Providers of Funds by issuing financial instruments and provide Funds to parties in need by subscribing to certain other types of Financial Instruments

Eg: Commercial banks, mutual funds and pension funds. Building Societies; Credit Unions; Insurance Companies etc.

Fee Based Intermediaries

These Financial Intermediaries/ Institutions offer advisory financial services and charge a fee accordingly for the services rendered

Eg: Investment Banking; Merchant banking, Issue Management, Underwriting' Portfolio Management, Stock Broking, Corporate Counseling, Credit Syndication

Banks & Financial Institutions

Banking Services, In general terms include the **activity of accepting and safeguarding money** owned by other individuals and entities, and **then lending/Investing out this money** in order to earn a profit.

Major Activities of Banking -

Retail Banking | Business Banking| Corporate Banking | Private Banking

Some of the Popular Categories of Banks in India are -

Commercial Banks | Co-operative Banks | Development Banks | Payments Banks

Broad Categories of Banks based on Ownership

Public Sector Banks - State Bank of India, Punjab National Bank, Bank of Baroda | Andhra Bank etc.

Private Sector Banks – Axis Bank, ICICI Bank, Kotak Bank, Bandhan Bank etc.

Banks & Financial Institutions

Types of Retail Products Offered -

Savings Account | Current Account| Term Deposit| Credit Cards |

Deposit Insurance Credit Guarantee Corporation (DICGC) –

- Is a subsidiary of Reserve Bank of India.
- Established for the purpose of providing insurance of deposits and guaranteeing of credit facilities.
- DICGC insures all bank deposits, such as saving, fixed, current, Recurring deposit for up to the limit of Rs. 100,000 of each deposits in a bank

Are Provisions under Financial Resolution & Deposit Insurance Bill (FRDA) Bill really harmful to deposit holders ??

Insurance Companies

The insurance companies offers services involving the insured assuming a guaranteed and known relatively **small premium** to the insurer **in exchange** for the insurer's promise to compensate the insured in the event of a covered loss.

Major Categories of Insurance in India -

Life Insurance (Only Human Life) | Non-Life (General) Insurance (Other Categories)

There is no-unified license concept in India. Separate License has to be obtained for each category of Insurance

Eg: HDFC Life Vs HDFC Ergo; Max Life Vs Max Bupa

Life Insurance runs on the 'Principal of Beneficiary' - That is the Self/Nominee will get the entire policy amount depending upon policy norms

Non-Life Insurance runs on the 'Principal of Indemnity' – That is make good the actual amount of Loss incurrd (Ex: Car Insurance for 5 Lakhs, repairs due to accident is INR 1 Lakh, Only 1 Lakh will be reimbursement)

Insurance Companies

Types of Life Insurances

Endowment Plans – Only Survival Benefits (if the person survives at the time of policy maturity)

Term Plans – Only Death Benefits (if the person dies during the policy tenure)

Endowment Assurance Plan – A hybrid Plan that offers benefits in either events (Survival or Death) (Etc: LIC Jeevan Anand)(Whole Life)

Unit Linked Insurance Plans (ULIPS) - Either Survival (Only market Value) or Death(Higher of Market Value or Sum Assured) – No-Fixed Term)

Mutual Funds

A **mutual fund** is a company that pools money from many investors and invests the money in securities such as stocks, bonds, and short-term debt.

The combined holdings of the **mutual fund** are known as its portfolio.

Investors buy shares(units)in **mutual funds**.

The Association of Mutual Funds in India (AMFI) – Self Regulatory Body of the Mutual Fund Industry

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 organisation.

As of now, all the 42 Asset Management Companies that are registered with SEBI, are its members.

Eg: www.mutualfundssahihai.com/en

Mutual Funds

Participants of Mutual Funds Organization-

Sponsors| Trust | Asset Management Companies | Custodians | Distributors

Classification of Mutual Funds Schemes

Open Ended Mutual Fund Schemes| Closed Ended Mutual Fund Schemes

Types of Mutual Funds –

Equity Funds - Invest predominantly in equities i.e. shares of companies. Primary objective is **wealth creation** or **capital appreciation**.

Debt Funds - Invest in Fixed Income Securities, like Government Securities or Bonds. Primarily for relatively **safer investments** and are suitable for **Income Generation**

Hybrid Funds- Invest in both Equities and Fixed Income, thus offering the best of both, **Growth Potential** as well as **Income Generation**

Non-Banking Finance Companies

Non-banking financial companies, or NBFCs, are financial institutions that provide certain types of banking services, but do not hold a **banking license**.

Fundamental Differences –

1. An NBFC cannot issues cheques drawn on itself
2. It cannot accept demand deposits
3. Need not comply with compliance with RBI regulations for banks

Asset Finance Company (AFC)

Gold Loans Company

Investment Company (IC)

Infrastructure Finance Company (IFC)

The Regulators

Regulators of Indian Financial System

Securities Exchange Board of India (SEBI)

(Capital Market Regulator, Stock Exchanges, Mutual Funds)

Reserve Bank of India (RBI)

(Money Market Regulator, Banking & NBFCs)

Insurance Regulatory & Development Authority (IRDA) –

(Insurance)

Insurance Regulatory & Development Authority (PFRDA)

(Pension Funds)

Thank You