Introduction to Financial Markets and Services

Topics

- Structure of Financial Systems
- Different Types of Financial Markets
- Different Types of Financial Intermediaries
- Regulators in Financial System

Financial System

- Financial system plays a key role in the economic growth and development of a nation.
- The strength of an economy is determined by key parameters like Gross Domestic Product (GDP), Inflation levels, Employment levels, composition and growth of Primary, Secondary and Tertiary sectors, Balance of trade and the position of balance of payments, Foreign exchange reserves it is carrying, Investment climate etc.
- All these parameters post positive figures when the economy has strong manufacturing setup, access to capital and domestic household savings and favorable conditions for trade and commerce.
- The supporting system for all these to happen in an economy is its Financial System. A financial system comprises of financial markets which are closely integrated, organized and regulated.
- The Financial markets in turn comprises of institutions who aim to meet the financing requirements of the corporate as well as individual households.
- The financial services offered by these financial markets and institutions cover both long-term as well as short-term finance requirements.

Structure of Financial System

Financial System Contd..

- A financial system is a combination of the following
  1. Financial Institutions
  2. Financial Markets
  3. Financial Instruments
  4. Financial Services

Financial System Contd..

- In any economy a successful financial system is established when
    1. There are minimal and simplified regulatory mechanisms
    2. The literacy levels of the investors are high
    3. Entry and Exit of the financial institutions into the financial system is smooth
    4. There is a favorable environment for inorganic growth options like Mergers, Acquisitions and Alliances
    5. The competitive environment is highly concentrated and restricted
    6. The entities operating in the financial system are given enough freedom and autonomy.
- Traditionally, for taking up new projects companies either rely on their cash surpluses or loans from banks and other financial institutions to meet the capital expenditure requirements.
- But increase in risk appetite of the retail investors post economic reforms led to the insurge of the huge capital inflows into equity markets, which gave the firms to access capital at cheaper rates from fresh sources.
- The investments in equity markets came not only from retail investors but also from Banks and financial institutions.

Financial System Contd..

- A strong financial system can help in achieving the following economic objectives
  - Channeling the supply of funds from fund issuers to fund raisers thereby addressing the demand supply gap for financial resources
  - To ensure that fiscal deficit is financed and maintained at controlled levels
  - To ensure the liquidity of money in the markets as per the requirements and economic policy adopted by the government
  - To ensure that the exchange rate of domestic currency is aligned to the requirements of the economy’s growth
  - To maintain a string banking system in the economy
  - To ensure that the economy is having surplus reserves of foreign exchange
  - To balance the interest rate regime in the economy so that the funds are at available are accessible rates to the corporate

Financial Institutions

- Financial institutions play the role of financial intermediaries and ensure that the gap between the investors and borrowers is bridged.
- The funds of the investors are collected in the form of deposits and are then given as loans to the borrowers.
- Generally the borrowers are corporate entities who seek funds from these financial institutions to fund their growth plans.
- Apart from seeking funds from these institutions, corporate can take their help in diversifying their existing business and also to restructure their existing capital structure.
- Financial institutions can be broadly classified into two categories
  - Banks
  - Non-Banking Financial Companies

Financial Markets

- Financial markets serve the funding needs of not only corporate but also individuals and other institutions through open market transactions.
- Generally the transactions at Financial institutions are personal in nature whereas the transactions in financial markets are impersonal in nature.
- Financial markets are classified into two groups based on the nature of financing
- Capital markets (Long-term)
- Money Markets (Short-term)

Financial Instruments

- Financial instruments are the means through which the financial markets operate.
- A financial instrument gives buyer a claim on a future payment in the form of dividend or interest payment for the payment of a sum of money.
- A financial instrument can be of two types
  - Primary Security
  - Secondary Security
- **Primary Securities**
- These securities are directly issued by the issuer to the subscriber either in the form of Equity shares, Preference shares or Debentures.
- **Secondary Securities**
- These securities are not directly issued by the issuer to the subscriber, albeit through a financial intermediary like a bank or an insurance company.
- Examples of secondary securities include Insurance Policies, Mutual Funds, Bank Deposits

Financial Services

- Financial services are the services offered by the financial institutions which include a broad range of services for facilitating the smooth functioning of the financial system.
- The entities operating in the financial services segment are
  1) Personal Finance and Wealth Management Companies
  2) Banks
  3) Insurance Companies
  4) Mutual Funds
  5) Credit Cards
  6) Non-Banking Financial companies
  7) Brokerage Firms
  8) Accountancy Firms
  9) Investment advisory Firms
  10) Forex management firms
- Generally financial services deal with the transactional and operational side of the financial system and facilitate buyers, sellers and intermediaries for smooth conduct of operations.

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Different Types of Financial Markets

- A financial market can be broadly classified into two important markets.
- They are Capital Market and Money Market.
- Capital Market is again classified into Securities Market and other forms of Borrowing and lending.
- Securities Market is again classified into two markets i.e. Primary Market and Secondary Market.
- The classification is depicted below for easy understanding
  - 1) Financial Markets
    - a) Money Market
    - b) Capital Market
      - i) Securities Market
        - (1) Primary Market
        - (2) Secondary Market
      - ii) Other Forms of Borrowing and lending

Different Types of Financial Markets Contd..

Money Market

- Money market deals with the entities who are interested in meeting their short term finance or investment requirements.
- Short-term surpluses of the individuals and corporate can be parked in money markets to fetch better returns whereas short-term finance deficits of corporate can as well be met through money markets.

Capital Market

- Capital market is an institutional arrangement which facilitates the movement of funds from investors to borrowers or fund seekers.
- Generally the transactions in capital market are aimed at meeting the long-term financing requirements.
- Though the timely nature of the investment differs between capital and money markets a same entity or financial institution can deal with both these markets.

Role of Financial Markets in an Economy

Financial markets in any economy try to accomplish the following objectives

- To address the financing needs of various entities in the financial system
- To facilitate the growth process of an economy
- To successfully play the role of an intermediary in channelizing the funds between fund issuers and find seekers
- To ensure that credit and liquidity needs of the market are efficiently met
- To ensure a smooth and convenience mechanism for availing financing and investment facilities

Regulators in Financial System

- The Indian financial system is regulated by the Indian government through its regulators.
- This strict regulatory regime helped Indian economy to withstand the 2008 US subprime crisis which pushed major economies of the world.
- There is no one single regulator controlling the entire financial system. Broadly there are five major regulatory bodies in India controlling its financial system. They are
- 1. Reserve Bank of India (RBI)
- 2. Securities and Exchange Board of India (SEBI)
- 3. Insurance Regulatory and Development Authority (IRDA)
- 4. Pension Fund Regulatory and Development Authority (PFRDA)

Reserve Bank of India (RBI)

- Reserve bank of India (RBI) was formed in the year 1935 as an institution of private shareholders, under the 1934 Act of Reserve Bank of India.
- After 1949, RBI was nationalized and it is completely owned by government of India. The primary aim of establishing RBI was to manage the currency and credit system of India by issuing currency as per the norms and maintaining sufficient reserves in order to ensure stability in the value of currency and money supply.
- RBI performs the following functions for smooth functioning of economy

 It advises government of India on key issues like

o Planning and mobilization of resources o Finance and Banking affairs

o Legislations on Housing, Agriculture and Industrial Finances

 It acts as a last resort for commercial banks in India to approach for finance

 It is a banker not only to the central government but also to state governments, which means all the payments and receipts of these governments are managed by RBI.

 It is the authority to print and circulate currency in India

Reserve Bank of India (RBI) Contd..

- It assists government in addressing fiscal deficit through sale and purchase of money market instruments
- Through its monetary policy initiatives RBI ensures that the availability of money supply in the economy is in line with the requirements by keeping inflation at controlled rates
- RBI intervenes as and when it required to check the exchange of its currency i.e. rupee visà-vis the currencies of trade
- It is the apex bank which regulates and monitors the functioning of banking and nonbanking operations in India
- It publishes reports on various macro-economic issues of the country and releases monetary and banking data, which helps government and think tanks to devise policies accordingly
- Besides the above mentioned functions RBI plays a key role in promoting the following activities
    - Industrial Credit and Finance
    - Rural and Agriculture Credit
    - Commercial Banking Activities
    - Co-Operative Banking and Export Finance

Reserve Bank of India (RBI) Contd..

To carry out the above mentioned functions RBI constituted various departments. The list of these departments are given below

- Consumer Education and Protection Department
- Corporate Strategy and Budget Department
- Department of Communication
- Department of Currency Management
- Department of Economic and Policy Research
- Department of External Investments and Operations
- Department of Government and Bank Accounts
- Department of Information Technology
- Department of Payment and Settlement Systems
- Department of Regulation
- Department of Statistics and Information Management

Reserve Bank of India (RBI) Contd..

- Department of Supervision
- Enforcement Department
- Financial Inclusion and Development Department
- Financial Markets Operation Department
- Financial Markets Regulation Department
- Financial Stability Unit
- FinTech Department
- Foreign Exchange Department
- Human Resource Management Department
- Inspection Department
- Internal Debt Management Department
- International Department
- Legal Department

Reserve Bank of India (RBI) Contd..

- Monetary Policy Department
- Premises Department
- Rajbhasha Department
- Risk Monitoring Department
- Secretary's Department
- Central Vigilance Cell

Securities and Exchange Board of India (SEBI)

- The Securities and Exchange Board of India (SEBI) is the regulator for the securities market in India. It was established in 1988 and given statutory powers on 12 April 1992 through the SEBI Act, 1992.
- Controller of Capital Issues was the regulatory authority before SEBI came into existence; it derived authority from the Capital Issues (Control) Act, 1947.
- Initially SEBI was a non-statutory body without any statutory power. However, in 1992, the SEBI was given additional statutory power by the Government of India through an amendment to the Securities and Exchange Board of India Act, 1992.
- In April 1988 the SEBI was constituted as the regulator of capital markets in India under a resolution of the Government of India.
- The SEBI is managed by its members, which consists of following: The chairman is nominated by Union Government of India.Two members, i.e., one officer from Union Finance Ministry and One member from the Reserve Bank of India.
- The remaining five members are nominated by Union Government of India; out of them at least three shall be whole-time members. After amendment of 1999, collective investment scheme brought under SEBI except NIDHI, chit fund and cooperatives.

Functions and Responsibilities of SEBI

- The Preamble of the Securities and Exchange Board of India describes the basic functions of the Securities and Exchange Board of India as "...to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected there with or incidental there to".
- SEBI has to be responsive to the needs of three groups, which constitute the market:
  - issuers of securities
  - investors
  - market intermediaries
- SEBI has three functions rolled into one body: quasi-legislative, quasi-judicial and quasi-executive. It drafts regulations in its legislative capacity, it conducts investigation and enforcement action in its executive function and it passes rulings and orders in its judicial capacity.
- Though this makes it very powerful, there is an appeal process to create accountability. There is a Securities Appellate Tribunal which is a three-member a second appeal lies directly to the Supreme Court. SEBI has taken a very proactive role in streamlining disclosure requirements to international standards.

Powers of SEBI

- For the discharge of its functions efficiently, SEBI has been vested with the following powers:

 to approve by−laws of Securities exchanges.

 to require the Securities exchange to amend their by−laws.

 inspect the books of accounts and call for periodical returns from recognized Securities exchanges.

 inspect the books of accounts of financial intermediaries.

 compel certain companies to list their shares in one or more Securities exchanges.

 registration of Brokers and sub-brokers

Insurance Regulatory and Development Authority (IRDA)

- The Insurance Regulatory and Development Authority of India (IRDAI) is an autonomous, statutory body tasked with regulating and promoting the insurance and re-insurance industries in India.
- It was constituted by the Insurance Regulatory and Development Authority Act, 1999, an Act of Parliament passed by the Government of India.
- The agency's headquarters are in Hyderabad, Telangana, where it moved from Delhi in 2001. IRDAI is a 10-member body including the chairman, five full-time and four part-time members appointed by the government of India.
- One hundred seven insurers were amalgamated and grouped into four companies:
- 1. National Insurance Company
- 2. New India Assurance Company
- 3. Oriental Insurance Company
- 4. United India Insurance Company.
- The General Insurance Corporation of India was incorporated in 1971, effective on 1 January 1973

Functions of IRDA

- The functions of the IRDAI are defined in Section 14 of the IRDAI Act, 1999, and include:

 Issuing, renewing, modifying, withdrawing, suspending or cancelling registrations

 Protecting policyholder interests

 Specifying qualifications, the code of conduct and training for intermediaries and agents

 Specifying the code of conduct for surveyors and loss assessors

 Promoting efficiency in the conduct of insurance businesses

 Promoting and regulating professional organisations connected with the insurance and reinsurance industry

 Levying fees and other charges

 Inspecting and investigating insurers, intermediaries and other relevant organisations

 Regulating rates, advantages, terms and conditions which may be offered by insurers not covered by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938)

 Specifying how books should be kept

 Regulating company investment of funds Regulating a margin of solvency 22 Adjudicating

Functions of IRDA

- Regulating company investment of funds
- Regulating a margin of solvency 22
- Adjudicating disputes between insurers and intermediaries or insurance intermediaries Supervising the Tariff Advisory Committee
- Specifying the percentage of premium income to finance schemes for promoting and regulating professional organisations
- Specifying the percentage of life- and general-insurance business undertaken in the rural or social sector
- Specifying the form and the manner in which books of accounts shall be maintained, and statement of accounts shall be rendered by insurers and other insurer intermediaries.

Pension Fund Regulatory and Development Authority (PFRDA)

- The Pension Fund Regulatory and Development Authority (PFRDA), a statutory body, is the pension regulator of India which was established by Government of India on August 23, 2003 and was authorized by Ministry of Finance, Department of Financial Services.
- Upon introduction of the PFRDA Bill by the Government of India in the Parliament of India and the subsequent passage of the PFRDA Act in 2013, the Authority became a Central Autonomous Body. Like other financial sector regulators namely Reserve Bank of India(RBI), Securities and Exchange Board of India (SEBI), Insurance Regulatory and Development Authority (IRDAI) and Insolvency and Bankruptcy Board of India (IBBI), PFRDA is a government regulatory body having executive, legislative and judicial powers.
- PFRDA promotes old age income security by establishing, developing and regulating pension funds and protects the interests of subscribers to schemes of pension funds and related matters.
- Currently, PFRDA is regulating and administering the National Pension System (NPS) along with administering the Atal Pension Yojana (APY) which is a defined benefits pension scheme for the unorganized sector, guaranteed by the Government of India.
- PFRDA is responsible for appointment of various intermediate agencies such as Central Record Keeping Agency (CRA), Pension Fund Managers, Custodian, NPS Trustee Bank, etc.The Authority consists of a Chairperson and not more than five members, of whom at least three shall be whole-time members, to be appointed by the Central Government.

Evolution of New Pension System and PFRDA

- PFRDA have set up a Trust under the Indian Trusts Act, 1882 to oversee the functions of the Pension Fund Managers (PFMs). The NPS Trust is composed of members representing diverse fields and brings wide range of talent to the regulatory framework.
- The Union Parliament passed the IPRDA [Interim Pension Fund Regulatory & Development Authority] Bill in February 2003 as a Budget 23 Announcement, approved by the then President of India, Dr. APJ Abdul Kalam.
- It was meant to be in place till the final and fool-proof system was prepared, re-approved, and implemented in a way acceptable to all political parties in India, including the opposition.
- Tamil Nadu became the first state to implement NPS for its newly appointed employees from the financial year 2003–04. On 19 September 2013, the President of India gave his assent to Pension Fund Regulatory and Development Authority Bill of 2013, which was passed in the Monsoon Session of Parliament on 4 September 2013 in the LokSabha and 6 September 2013 in the RajyaSabha, to make it a Permanent Act.
- This improved, foolproof and re-approved Bill, with the acceptance of all political parties in India, has replaced the old and imperfect IPRDA Bill of 2003.
- The President of India is the guardian of the PFRDA, subject to his Financial Emergency Powers, as per the Articles of Indian Constitution. PFRDA now has Full Autonomy & functioning independently from F.Y. 2014-15.

Thank You