CHAPTER 11

INDIAN FINANCIAL MARKET

*There is now ample empirical research to corroborate Schumpeter's conjecture that financial development facilitates real economic growth. The depth of the financial markets and availability of diverse products should therefore not be treated as mere adornment but as critical ingredients of inclusive growth.**

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* *As the* ***Economic Survey 2011–12*** *refers to the Australian economist Joseph A. Schumpeter (1883–1950) to emphasise the importance of the financial market in an economy.* See Ministry of Finance, ***Economic Survey 2011–12*** (New Delhi: Government of India, 2012), p. 40.

INTRODUCTION

The market of an economy where funds are transacted between the fund-surplus and fund-scarce individuals and groups is known as the financial market *(definition)*.[1] The basis of transaction is either *interest* or *dividend*. This market might have its organised (institutionalised) as well as non-organised (unregulated/non-institutionalised) segments in an economy.

Financial markets in every economy are having two separate segments today, one catering to the requirements of *short-term funds* and the other to the requirements of *long-term funds*.[2] The short-term financial market is known as the **money market,** while the long-term financial market is known as the **capital market.** The money market fulfils the requirements of funds for the period upto 364 days (*i.e., short term*) while the capital market does the same for the period above 364 days (*i.e., long term*).[3] A brief discussion on the Indian financial market is given below.

INDIAN MONEY MARKET

Money market is the short-term financial market of an economy. In this market, money is traded between individuals or groups (i.e., financial institutions, banks, government, companies, etc.), who are either *cash-surplus* or *cash-scarce*. Trading is done on a rate known as *discount rate* which is determined by the market and guided by the availability of and demand for the cash in the day-to-day trading.[4] The 'repo rate' of the time (announced by the RBI) works as the guiding rate for the current 'discount rate'. Borrowings in this market may or may not be supported by collaterals. In the money market the *financial assets*, which have quick conversion quality into money and carry minimal transaction cost, are also traded.[5] Money market may be *defined* as a market where short-term lending and borrowing take place between the cash-surplus and cash-scarce sides.

The market operates in both 'organised' and 'unorganised' channels in India. Starting from the 'person-to-person' mode and converting into 'telephonic transaction', it has now gone *online* in the age of internet and information technology. The transactions might take place through the intermediaries (known as brokers) or directly between the trading sides.

Need for Money Market: Income generation (i.e., growth) is the most essential requiremnt of any economic system. In the modern industrial economies creation of productive assets is not an easy task, as it requires investible capital of long-term nature. Long-term capital can be raised either through bank loans, corporate bonds, debentures or shares (i.e., from the capital market). But once a productive asset has been created and production starts there comes the need of another kind of capital, to meet the day-to-day shortfalls of working capital. It means that only setting-up of firms does not guarantee production as these firms keep facing *fund mismatches* in the day-to-day production process. Such funds are required only for a short period (days, fortnights or few months)

1. Based on the discussion in P.A. Samuelson and W.D. Nordhaus, ***Economics*** (New Delhi: Tata McGrawHill, 2005), pp. 543–45.
2. Based on J.E. Stiglitz and C.E. Walsh, ***Economics*** (New York: W.W. Norton & Campany, 2006), pp. 612–14.
3. See Reserve Bank of India, ***Report on Currency and Finance*** (New Delhi: Government of India, multiple years).
4. In the capital market, money is traded on interest rate as well as on dividends. Long-term loans are raised on well-defined interest rates, while long-term capital is raised on dividends through the sale of shares.
5. Such financial assets are known as 'close substitutes for money.'

and are needed to meet shortfalls in working capital requirements. This requires creation of a different segment of the financial market which can cater to the short-term requirements of such funds for the eneterprises—known as the **money market** or the **working capital market.** The short-term period is defined as upto 364 days.

The crucial role money market plays in an economy is proved by the fact that if only a few lakhs or crores of rupees of working capital is not met in time, it can push a firm or business enterprise to go for lock-out, which has been set-up with thousands of crores of capital. If lock-out happens, the firm might default in its payments, losing its age-old credit-worthiness, consequently creating a chain of negatives in the economic system. This is why it is essential for every economy to organise a strong and vibrant money market which has wider geographic presence (the reason why it is today internet-based).

Money Market in India: The organised form of money market in India is just close to three decades old. However, its presence has been there, but restricted to the government only.[6] It was the **Chakravarthy Committee** (1985) which, for the first time, underlined the need of an organised money market in the country[7] and the **Vahul Committee** (1987) laid the blue print for its development.[8] Today, money market in India is not an integrated unit and has two segments—*Unorganised Money Market* and *Organised Money Market*.

6. The only instrument of the money market was the Treasury Bills, which were sold by tender at weekly auctions upto 1965. But later these bills were made available throughout the week at discount rates by the Reserve Bank of India.
7. Sukhomoy Chakravarthy, ***Review of the Working of the Monetary System*** (New Delhi: Reserve Bank of India, 1985).
8. M. Vaghul, ***Working Group on Money Market*** (New Delhi: Reserve Bank of India, 1987). The committee was set up in 1986, and came to be known as the Vaghul Committee.

I. UNORGANISED MONEY MARKET

Before the government started the organised development of the money market in India, its unorganised form had its presence since the ancient times—its remnant is still present in the country. Their activities are not regulated like the organised money market, but they are recognised by the government. In recent years, some of them have been included under the regulated organised market (for example, the NBFCs were put under the regulatory control of the RBI in 1997). The unorganised money market in India may be divided into three differing categories:

(i) Unregulated Non-Bank Financial Intermediaries: Unregulated Non-Banking Financial Intermediaries are functioning in the form of *chit funds, nidhis* (operate in South India, which lend to only their members) and loan companies. They charge very high interest rates (i.e., 36 to 48 per cent per annum), thus, are exploitative in nature and have selective reach in the economy.

(ii) Indigenous Bankers: Indigenous bankers receive deposits and lend money in the capacity of an individual or a private firms. There are, basically, four such bankers in the country functioning as non-homogenous groups:

(a) *Gujarati Shroffs*: They operate in Mumbai, Kolkata as well as in industrial, trading and port cities in the region.

(b) *Multani* or *Shikarpuri Shroffs*: They operate in Mumbai, Kolkata, Assam tea gardens and North Eastern India.

(c) *Marwari Kayas*: They operate mainly in Gujarat with a little bit of presence in Mumbai and Kolkata.

(d) *Chettiars*: They are active in Chennai and at the ports of southern India.

(iii) Money Lenders: They constitute the most localised form of money market in India and operate in the most exploitative way. They have their two forms:

(a) The professional money lenders who lend their own money as a profession to earn income through interest.

(b) The non-professional money lenders who might be businessmen and lend their money to earn interest income as a subsidiary business.

Today, India has **eight** organised instruments of the money market which are used by the prescribed firms in the country, but the unorganised money market also operates side by side—there are certain reasons[9] behind this:

(i) Indian money market is still under-developed.

(ii) Lack of penetration and presence of the instruments of the organised money market.

(iii) There are many needful customers in the money market who are currently outside the purview of the organised money market.

(iv) Entry to the organised money market for its customers is still restrictive in nature—not allowing small businessmen.

2. Organised Money Market

Since the government started developing the organised money market in India (mid-1980s), we have seen the arrival of a total of **eight** instruments designed to be used by different categories of business and industrial firms. A brief description of these instruments follows:

(i) *Treasury Bills (TBs):* This instrument of the money market though present since Independence got organised only in 1986. They are used by the Central Government to fulfil its short-term liquidity requirement upto the period of 364 days. There developed **five types** of the TBs in due course of time:

(a) 14-day (Intermediate TBs)

(b) 14-day (Auctionable TBs)

(c) 91-day TBs

(d) 182-day TBs

(e) 364-day TBs

Out of the above five variants of the TBs, at present only the **91-day TBs**, **182-day TBs** and the **364-day TBs** are issued by the government. The other two variants were discontinued in 2001.[10]

The TBs other than providing short-term cushion to the government, also function as short-term investment avenues for the banks and financial institutions, besides functioning as requirements of the CRR and SLR of the banking institutions.

(ii) *Certificate of Deposit (CD):* Organised in 1989, the CD is used by **banks** and issued to the depositors for a specified period ranging less than one year—they are negotiable and tradable in the money market. Since 1993 the RBI allowed the **financial institutions** to operate in it—IFCI, IDBI, IRBI (IIBI since 1997) and the Exim Bank—they can issue CDs for the maturity periods above one year and upto three years.

(iii) *Commercial Paper (CP):* Organised in 1990 it is used by the **corporate houses** in India (which should be a listed company with a working capital of not less than Rs. 5 crore). The CP issuing companies need

9. Based on the suggestions of experts belonging to the Indian financial market.

10. Ministry of Finance, ***Economic Survey 2001–02*** (New Delhi: Government of India, 2002); Ministry of Finance, Economic Survey 2009–10 (New Delhi: Government of India, 2010).

to obtain a specified credit rating from an agency approved by the RBI (such as CRISIL, ICRA, etc).

(iv) *Commercial Bill (CB):* Organised in 1990, a CB is issued by the **All India Financial Institutions** (AIFIs), **Non-Banking Finance Companies** (NBFCs), **Scheduled Commercial Banks, Merchant Banks, Co-operative Banks** and the **Mutual Funds**. It replaced the old Bill Market available since 1952 in the country.

(v) *Call Money Market (CMM):* This is basically an **inter-bank** money market where funds are borrowed and lent, generally, for one day—that is why this is also known as **over-night borrowing market** (also called **money at call**). Fund can be borrowed/raised for a maximum period upto 14 days (called **short notice**). Borrowing in this market may take place against securities or without securities.[11] Rate of interest in this market 'glides' with the 'repo rate' of the time the principle remains very simple—longer the period, higher the interest rate. Depending upon the availability and demand of fund in this market the real call rate revolves nearby the current repo rate.

The scheduled commercial banks, co-operative banks operate in this market as both the borrowers and lenders while LIC, GIC, Mutual Funds, IDBI and NABARD are allowed to operate as only lenders in this market.

(vi) *Money Market Mutual Fund (MF):* Popular as Mutual Funds (MFs) this money market instrument was introduced/organised in 1992 to provide short-term investment opportunity to **individuals**. The initial guidelines for the MF have been liberalised many times. Since March 2000, MFs have been brought under the preview of SEBI, besides the RBI. At present, a whole lot of financial institutions and firms are allowed to set up MFs, viz., commercial banks, public and private financial institutions and private sector companies. At present 42 MFs are operating in the country—managing a corpus of over Rs. 20.4 lakh crore (by March 2018).

(vii) *Repos and Reverse Repos:* In the era of economic reforms there developed two new instruments of money market—**repo** and **reverse repo.** Considered the most dynamic instruments of the Indian money market they have emerged the most favoured route to raise short-term funds in India. 'Repo' is basically an acronym of the **rate of repurchase.** The RBI in a span of four years, introduced these instruments—**repo** in December 1992 and **reverse repo** in November 1996.

Repo allows the banks and other financial institutions to borrow money from the RBI for short-term (by selling government securities to the RBI). In **reverse repo,** the banks and financial institutions purchase government securities from the RBI (basically here the RBI is borrowing from the banks and the financial institutions). All government securities are dated and the interest for the repo or reverse repo transactions are announced by the RBI from time to time. The provision of repo and the reverse repo have been able to serve the liquidity evenness in the economy as the banks

11. The State Bank of India (operates in this market as lender as it is in a comfortable cash position) lends against government securities, while others lend against the 'deposit receipts' of the borrowing banks. The SBI functions as the 'lender of intermediate resort' (while the RBI functions as the 'lender of last resort').

are able to get the required amount of funds out of it, and they can park surplus idle funds through it. These instruments have emerged as important tools in the management of the monetary and credit policy in recent years.[12]

Accepting the recommendations of the **Urjit Patel Committee**, the RBI in April 2014 (while announcing the first *Bi-monthly Credit & Monetary Policy-2014–15*) announced to introduce **term repo** and **term reverse repo**. This is believed to bring in higher stability and better signalling of interest rates across different loan markets in the economy.

(viii) *Cash Management Bill (CMB):* The Government of India, in consultation with the RBI, decided to issue a new short-term instrument, known as Cash Management Bills, since August 2009 to meet the temporary cash flow mismatches of the government. The Cash Management Bills are *non-standard* and *discounted instruments* issued for maturities less than 91 days.

The CMBs have the *generic character of Treasury Bills* (issued at discount to the face value); are tradable and qualify for *ready forward facility;* investment in it is considered as an eligible investment in government securities by banks for SLR.

It should be noted here that the existing Treasury Bills serve the same purpose, but as they were put under the WMAs (Ways & Means Advances) provisions by the Government of India in 1997, they did not remain a discretionary route for the government in meeting its short-term requirements of funds at will (see 'Fiscal Consolidation in India', sub-topic in **Chapter 18** *Public Finance* for details). CBM does not come under the similar WMAs provisions.

12. Reserve Bank of India, ***Report on Currency and Finance*** (New Delhi: Government of India, 1999); Reserve Bank of India, Report on Currency and Finance (New Delhi: Government of India, 2000).

MUTUAL FUNDS

Of all investment options, mutual funds are touted to be the best tool for wealth creation over the long term. They are of several types, and the risk varies with the kind of asset classes these funds invest in. As the name suggests, a mutual fund *is a fund that is created when a large number of investors put in their money, and is managed by professionally qualified persons with experience in investing in different asset classes—shares, bonds, money market instruments like call money, and other assets such as gold and property.* Their names usually give a good idea about what type of asset class a fund, also called a scheme, will invest in. For example, a **diversified equity fund** will invest in a large number of stocks, while a **gilt fund** will invest in government securities, while a **pharma fund** will mainly invest in stocks of companies from the pharmaceutical and related industries.

Mutual funds, first of all came in the money market (regulated by the RBI), but they have the freedom to operate in the capital market, too. This is why they have provision of dual regulator—the RBI and SEBI. Mutual funds are compulsorily registered with the Securities and Exchange Board of India (SEBI), which also acts as the **first wall of defence** for all investors in these funds. For those who do not understand how mutual funds operate but are willing to invest, the move by SEBI is seen as a big relief.

Each mutual fund is run by a group of qualified people who form a company, called an *asset* *management company (AMC)* and the operations of the AMC are under the guidance of another group of people, called *trustees.* Both, the people in the AMC as well as the trustees, have a *fiduciary responsibility,* because these are the people who are entrusted with the task of managing the hard-earned money of people who do not understand much about managing money.

A fund house or a distributor working for the fund house (which could be an individual, a company or even a bank) are qualified to sell mutual funds. The fund house allots the 'units' of the MF to the investor at a price that is fixed through a process approved by SEBI, which is based on the net asset value (NAV). In simple terms, NAV is the total value of investments in a scheme divided by the total number of units issued to investors in the same scheme. In most mutual fund schemes, NAVs are computed and published on a daily basis. However, when a fund house is launching a scheme for the first time, the units are sold at Rs. 10 each. There are **three types** of schemes offered by MFs:

(i) Open-ended Schemes: An open-ended fund is one which is usually available from an MF on an ongoing basis, that is, an investor can buy or sell as and when they intend to at a NAV-based price. As investors buy and sell units of a particular open-ended scheme, the number of units issued also changes every day and so changes the value of the scheme's portfolio. So, the NAV also changes on a daily basis. In India, fund houses can sell any number of units of a particular scheme, but at times fund houses restrict selling additional units of a scheme for some time.

(ii) Closed-ended Schemes: A close-ended fund usually issue units to investors only once, when they launch an offer, called *new fund offer (NFO)* in India. Thereafter, these units are listed on the stock exchanges where they are traded on a daily basis. As these units are listed, any investor can buy and sell these units through the exchange. As the name suggests, close-ended schemes are managed by fund houses for a limited number of years, and at the end of the term either money is returned to the investors or the scheme is made open ended. However, there is a word of caution here that usually, units of close ended funds which are listed on the stock exchanges, trade at a high discount to their NAVs. But as the date for closure of the fund nears, the discount between the NAV and the trading price narrows, and vanishes on the day of closure of the scheme.

(iii) Exchange-Traded Funds (ETFs): ETFs are a mix of open-ended and close-ended schemes. ETFs, like close-ended schemes, are listed and traded on a stock exchange on a daily basis, but the price is usually very close to its NAV, or the underlying assets, like gold ETFs.

If investment have been done in a well-managed MF, the advantages outweigh disadvantages in the long term, which is 10 years or more. There is a very high probability for investors of making more money than by investing in other risk-free investments such as FDs, public provident fund etc. Advantages of investing in MFs include:

(a) diversification of portfolio,

(b) good investment management services,

(c) liquidity,

(d) strong government-backed regulatory help,

(e) professional service, and
(f) low cost for all the benefits.

An investor, by investing in a mutual fund scheme that has blue chip stocks in its portfolio, indirectly gets an exposure to these stocks. Compared to this, if the same investor wants to have each of these stocks in his portfolio, the cost of buying and managing the portfolio will be much higher.

Mutual funds invest the investors money in both the **loan** and **share** markets. Buyers of MF units are given choice/option as in which of the markets they wish their money to be invested by the fund managers of the MF. This way investors get the following choices:

(i) *Loan* (100 per cent of the funds will be invested in the loan market),
(ii) *Share* (100 per cent of the funds will be invested in the share market), and
(iii) *Balance* (60 per cent of the funds will be invested in the loan market while the rest 40 per cent in the share market—this provision keeps changing depending upon the health of the share market—clearly announced by the MFs).

By *October 2017*, the SEBI (Securities and Exchange Board of India) announced to classify the mutual fund schemes into *five broad categories* to cut through the clutter and make it easier for investors to compare plans with similar characteristics—Debt, Equity, Hybrid, Solution-oriented (such as retirement and children funds), and other schemes.

Every class is further finely divided, making for a total of *36 different scheme* categories such as Dividend Yield Equity Fund, which would focus on dividend-yielding stocks, or Banking and PSU Debt Fund, which invests a minimum 80 per cent of its corpus in debt paper issued by state-owned firms and lenders. A fund house will be allowed to have only one scheme per category to ensure that there is no duplication.

DFHI

The Discount and Finance House of India Limited[13] (DFHI) was set up in April 1988 by the RBI jointly with the public sector banks and financial investment institutions (i.e., LIC, GIC and UTI). Its establishment was an outcome of the long-drawn need of the following two types:

(i) to bring an equilibirium of liquidity in the Indian banking system and
(ii) to impart liquidity to the instruments of the money market prevalent in the economy.

In 2004, the RBI transferred its total holding in the DFHI to the State Bank of India arm SBI Gilts Limited. Its new name is SBI DFHI. It functions as the biggest 'primary dealer' in the economy and functions on commercial basis. It deals in all kinds of instruments in the money market without any upper ceiling. Operating in 'two way' (as a lender and borrower) its objective is to provide needful liquidity and stability in the financial market of the country.

13. It was in 1979 that the Chore Committee for the first time recommended for a discount house to level the liquidity imbalances in the banking system. The government became active after the recommendations of the Working Group on the Money Market (i.e., the Vaghul Committee, 1987) and finally established DFHI in 1988. The Vaghul Committee suggested to set up a discount finance institution which could deal in short-term money market instruments so that liquidity could be provided to these instruments. The committee also recommended the house to operate on 'commercial basis', which was accepted by the government while setting up DFHI.

INDIAN CAPITAL MARKET

The long-term financial market of an economy is known as the 'capital market'. This market makes it possible to raise *long-term money* (capital), i.e., for a period of minimum 365 days and above. Ceation of productive assets is not possible without a string capital market—the market gained more importance once most of the economies in the world started industrialising. Across the world, banks emerged as the first and the foremost segment of the capital market. In coming times many other segments got added to it, viz., insurance industry, mutual funds, and finally the most attractive and vibrant, the security/stock market. Organised development of capital market together with putting in place the right regulatory framework for it, has always been a tough task for the economies. It is believed today that for strong growth prospects in an economy presence of a strong and vibrant capital market is essential.

Though the capital market of India is far stronger and better today in comparision to the periods just after Independence, the process of emergnece has not been easy and smooth. Once India opted 'industry' as its prime moving force, the first challenge was to raise long-term funds for industrial establishments and their expansion. As banks in India were weak, small and geographically unevenly distributed they were not in a position to play the pivotal role they played in case of the industrialising Western economies. This is why the government decided to set up 'financial institutions' which could play the role of banks (till banks gain strength and presence) and carry on the responsibilities of 'project financing'.

PROJECT FINANCING

After Independence, India went for intensive industrialisation to achieve rapid growth and development. To this end, the main responsibility was given to the Public Sector Undertakings (PSUs). For industrialisation we require capital, technology and labour, all being typically difficult to manage in the case of India. For capital requirement, the government decided to depend upon internal and external sources and the government decided to set up financial institutions (FIs). Though India was having banks, but due to low saving rate and lower deposits with them, the upcoming industries could not be financed through them. The main borrowers for industrial development were the PSUs. To support the capital requirement of the 'projects' of the public sector industries, the government came up with different types of financial institutions in the coming years. The industrial financing supported by these financial institutions was known as 'project financing' in India. Over the time, Indian capital market started to have the following segments:

I. FINANCIAL INSTITUTIONS

The requirement of project financing made India to go for a number of FIs from time to time, which are generally classified into four categories:[14]

(i) All India Financial Institutions (AIFIs)

The all India FIs are IFCI (1948); ICICI (1955); IDBI (1964); SIDBI (1990) & IIBI (1997). All of them were public sector FIs except ICICI, which was a joint sector venture with initial capital coming from the RBI, some foreign banks and FIs. The public sector FIs were funded by the Government of India.

By 1980s, all Indian banks acquired wider capital base and by early 1990s when the stock market became popular, it became easier for the corporate world to tap cheaper capital from these segments of the capital market.[15] The era of economic reforms had given the same option to the PSUs to tap new capital. As the AIFIs had more or

14. ***Industrial Finance Corporation of India Act, 1948***, Government of India, New Delhi.
15. Ministry of Finance, ***Economic Survey 2000-01***, (New Delhi: Government of India, 2010).

less fixed rate of interest as compared to the banks which could mobilise cheaper deposits to lend cheaper—the AIFIs seemed to become irrelevant. The AIFIs witnessed a sharp decline in recent years.[16] At this juncture the government decided to convert them into **Development Banks**[17] (suggested by the Narasimhan Committee-I) to be known as the All India Development Banks (AIDBs). In 2000, the government allowed ICICI to go for a **reverse merger** (when an elder enterprise is merged with a younger one) with the ICICI Bank—the first AIDB emerged with no obligation of project financing—such entities in coming times will be known as the **universal banks**[18] (allowed to set up as many financial institutions they wish to, such as insurance, merchant banks, mutual funds, etc.). In a similar move, the IDBI was reverse merged with the IDBI Bank in 2002 and the second AIDB emerged. But it has still the obligation of carrying its project financing duties.

In 2002, the government, proposed to merge IFCI and IIBI with the nationalised bank PNB to ctraete a big **Universal Bank.** It is believed that PNB was unwilling to go for this merger as these FIs were running at heavy losses. This move was part correct as per the recommendations of the Narasimhan Committe-II (to the extent merger is concerned, following its 3-Tier Banking Structure of India), but part against it (the committee has advised not to merge weak banks/FIs with either weak or strong banks/FIs).[19] Presently, the government is trying to make IFCI and IIBI to turn around their business and emerge as profitable entities—they are busy recovering their dues and improving their balance sheet.

Meanwhile, at present, there are only **four** financial institutions operating in the country as AIFIs **regulated** by the RBI, viz., the NABARD, SIDBI, Exim Bank and the NHB.

(ii) Specialised Financial Institutions (SFIs)[20]

Two new FIs were set up by the Central Government in the late 1980s to finance **risk** and **innovation** in the area of industrial expansion; this was India's trial in the area of **venture capital funding**.

(a) *IFCI Venture Capital Funds Ltd (IFCI Venture), 2000:* It was promoted as a Risk Capital Foundation (RCF) in 1975 by IFCI Ltd., a society to provide financial assistance to first generation professionals and technocrat entrepreneurs for setting up own ventures through soft loans, under the Risk Capital Scheme.

In 1988, RCF was converted into a company—Risk Capital and Technology Finance Corporation Ltd. (RCTC)—when it also introduced the Technology Finance and Development Scheme (TFDS) for financing development and commercialisation of indigenous technology. Besides, under Risk Capital Scheme, RCTC started providing financial assistance to entrepreneurs by way of direct equity participation. Based on IFCI Venture's credentials and strengths, Unit Trust of India (UTI), entrusted RCTC with the management of a new venture capital fund named **Venture Capital Unit Scheme (VECAUS-III)** in 1991 with its funds coming from the UTI and IFCI. To reflect the shift in the

16. Ministry of Finance, ***Economic Survey 2006-07,*** (New Delhi: Government of India, 2007).
17. **Narasimhan Committee on the Financial System (CFS), 1991** suggested for the conversion of the AIFIs into Development Banks.
18. It was the **S. H. Khan Committee on Development Financial Institutions (DFIs), 1998** which forwarded the concept/idea of Universal Banking in India.
19. Ministry of Finance, ***Economic Survey 2011–12*** (New Delhi: Government of India, 2011), pp. 115–16.
20. The write-up is based on information available from **SEBI, RBI** and different announcements/published reports of the **Ministry of Finance,** since 1996 onwards.

company's activities, the name of RCTC was changed to IFCI Venture Capital Funds Ltd. (IFCI Venture) in February 2000.

In order to focus on Asset Management Activities, IFCI Venture discontinued Risk Capital and Technology Finance Schemes in 2000-01 and continued managing VECAUS-III. In 2007, as UTI had ceased to carry out its activities and its assets vested with **Specified Undertaking of the Unit Trust of India (SUUTI)**, the portfolio of VECAUS-III under management of IFCI Venture was transferred to SUUTI.

(b) *Tourism Finance Corporation of India Ltd (TFCI), 1989:* The Government of India had, on the recommendations of the National Committee on Tourism *(Yunus Committee)* set up under the aegis of the Planning Commission, decided in 1988, to promote a separate All India Financial Institution for providing financial assistance to tourism-related activities/projects. In accordance with the above decision, the IFCI Ltd. along with other all-India financial/investment institutions and some nationalised banks promoted a Public Limited Company under the name of "Tourism Finance Corporation of India Ltd. (TFCI)" to function as a Specialised All-India Development Financial Institution to cater to the financial needs of the tourism industry.

TFCI was incorporated as a Public Limited Company in 1989 and became operational with effect from 1989. TFCI was notified as a Public Financial Institution in January 1990. Its promoter, the IFCI, holds major share (41.6 per cent) in it, while the rest of the shares are with the 'public' (26 per cent), public sector banks, public insurance companies and public mutual fund (i.e., UTI Mutual Fund Ltd.).

(iii) Investment Instituions (IIs)

Three investment institutions also came up in the public sector, which are yet another kind of FIs, i.e., the LIC (1956), the UTI (1964) and the GIC (1971).

In the present time they are no more known as DIIs (Domestic Investment Institutions) or DFIs (Domestic Financial Institutions). LIC is now the public sector insurance company in the life segment, GIC was been converted into a public sector re-insurance company in 2000, while UTI was converted into a mutual fund company in 2002. Now these investment institutions (IIs) are no more like the past. LIC is now called an 'insurance company', part of the Indian Insurance Industry and is the lone public sector playing in the life insurance segment competing with the private life insurance companies. Similarly, the UTI is now part of the Indian Mutual Fund industry and the lone such firm in the public sector competing with other private sector mutual funds. Similarly, the earstwhile four public sector general insurance companies are part of India's general insurance industry and competing with private companies in the area (they were Holding Comapnies of the GIC—now these are owned by the GoI directly and GIC only looks after its 're-insurance' business). This is why we do not get the use of the term 'IIs' in recent times in any of the GoI official documents.

(iv) State Level Finance Institutions (SLFIs)

In the wake of states involvement in the industrial development, the central government allowed the states to set up their own financial institutions (after the states demanded so). In this process two kinds of FIs came up:

(a) *State Finance Corporations (SFCs):* First came up in Punjab (1955) with other states following its example. There are 18 SFCs working presently.

(b) *State Industrial Development Corporations (SIDCs):* A fully dedicated state public sector FI to the cause of industrial development in the concerned states. First such FIs were set up (1960) in Andhra Pradesh and Bihar.

Almost all of the SFCs and SIDCs are at present running in huge losses. They may be re-structured on the lines of the AIFIs, but there is lack of will from the states and private financiers who are not interested to go in for their takeovers as such.

2. BANKING INDUSTRY

With the passage of time, the industry saw its nationalisation (1969 and 1980) and again opening up for private sector entry (1993–94) to emerge as the most dependable segement of Indian financial system—in a way its mainstay. Presently, the industry consists of commercial banks both in public and private sectors, Regional Rural Banks (RRBs) and co-operative banks—a total of 171 Scheduled Commercial Banks (SCBs) out of whch 113 are in the public sector (19 nationalised banks, 7 banks in SBI group, one IDBI Bank Ltd. and 86 RRBs); with the rest of the 58 banks owned by the private sector (domestic and foreign—FDI in banks is allowed upto 26 per cent).[21]

In the wake of the economic reforms the government has promised speedier expansion of the banking sector. But the entry of new private players in the banking sector has been slow, hapmering the growth and expansion of the sector. But in a *recent release* the RBI has committed to allow new banks to come up on regular basis—in **April 2014** the RBI allowed two new private sector banks to start their operations. [for a detailed discussion on the banking sector refer the *Chapter 12*].

3. INSURANCE INDUSTRY

After Independence, for the purpose of expanding the industry, one after another the life and non-life insurance businesses were nationalised by the government (in 1956 and 1970, respectively), and the public sector insurance companies did serve the better purpose in the areas of providing safety net and nation-building. In the wake of the process of economic refroms a restructuring of the sector was started and the industry was opened for entry of private players in 1999 and an independent regulator was set up—the IRDA (domestic and foreign—with an FDI cap of 49 per cent). Since then many private players have entered the industry. Presently, Indian insurance industry consists of one public sector life insurer (LIC) and four public sector general insurers; two specialised public sector insurers (AICIL and ECGC); one public sector re-insurer (GIC) and 37 private insurance companies (in collaboration with established foreign insurers from across the world).[22] The expansion and penetration insurance in the country have increased during the reform period, but not as per the expectations of the governments and the experts—several reasons have been responsible for this (for a detailed discussion on the insurance industry refer *Chapter 13*).

4. SECURITY MARKET

After the government's attempts to formally organise the security and stock market of India, the segment has seen accelerated expansion. Today, it is counted among the most vibrant share markets of the world and has challenged the monopoly of banks in the capital market of the country.[23] The

21. Publications Division, ***India 2014***, (New Delhi: Government of India, 2015), p. 326.
22. Ibid, p. 329.
23. Ministry of Finance, ***Economic Survey 2012–13*** (New Delhi: Government of India, 2013), p. 116.

security market of India is regulated by SEBI. India has developed a regulated 'forward market' also where hunderds of commodities and derivatives are traded on spot and non-spot basis—regulated by FMC which merged into SEBI by late 2015.

FINANCIAL REGULATION

India has a multiple regulatory architecture in the financial sector. The design has developed complexities over the time due to: the *number* of regulatory, quasi-regulatory, non-regulatory-but-still-regulating bodies; *overlapping ambiguous* operational design and their influence.[24] A brief overview of the financial regulatory framework is being give here.

REGULATORY AGENCIES

India has product-wise regulators—Reserve Bank of India (RBI) regulates credit products, savings and remittances; the Securities and Exchange Board of India (SEBI) regulates investment products; the Insurance Regulatory and Development Authority (IRDA) regulates insurance products; and the Pension Fund Regulatory and Development Authority (PFRDA) regulates pension products. The Forward Markets Commission (FMC) regulates commodity-based exchange-traded futures (which was merged with the SEBI by late 2015).

Certain entities, primarily engaged in one product (i.e., the insurance companies) also offer other products making it difficult for product-based regulation (this came to light in the PFRDA-IRDA controversy of early 2010s). Thus, most regulation turns out to be entity-based. Another example is of *cooperative banks*, which, except in terms of their ownership structure, are very much like other banks—they take deposits and give loans. Still, their regulation is largely left to the Registrar of Cooperatives.

24. **Financial Sector Legislative Reforms Commission** report, March 2013, N. Delhi.

QUASI-REGULATORY AGENCIES

Several other government bodies perform quasi-regulatory functions—National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI), and National Housing Bank (NHB). NABARD supervises regional rural banks as well as state and district cooperative banks. NHB regulates housing finance companies, and SIDBI regulates the state finance corporations (SFCs).

CENTRAL MINISTRIES

Certain ministries of the GoI also involved in policy making in the financial system. Ministry of Finance (MoF) is most prominently involved, through its representatives on the Boards of SEBI, IRDA and RBI. MoF and Ministry of Small Scale Industries have representatives on SIDBI Board, and Ministry of Urban Development is represented on the NHB Board. MoF representatives are also on Boards of public sector banks (PSBs) and Development Financial Institutions (DFIs). Forward Market Commission (FMC), which used to regulate the commodity exchanges and brokers, under the Ministry of Consumer Affairs, shifted to the Ministry of Finance in 2014 (merged with the SEBI, MoF by September, 2015).

STATE GOVERNMENTS

Through the Registrar of Cooperatives, who are under the departments of agriculture and cooperation, the state governments regulate the cooperative banking institutions in their respective states. The state government have also sometimes claimed a regulatory role in certain other cases. Though it never became an open battle, the Andhra Pradesh government's Ordinance directing operations of Micro Finance Institutions (MFIs)—many of them NBFCs registered with and regulated by RBI—falls into this space.

Such actions by state government have been matters of contention in the past as well, and some of them have gone to the courts, too (the judgement on the court cases to clarify the *RBI vs. State Government* issue are before the Supreme Court).

Special Statutes for Certain Financial Intermediaries

Some key financial services intermediaries like SBI (and its Associate Banks before their consolidation with SBI in 2017-18), Public Sector Banks, LIC and GIC are governed by their own statutes. These statutes give a special status to these institutions vis-á-vis the other institutions performing the same functions. Earlier, IFCI, UTI and IDBI also operated under special statutes, but now there special statutes have been repealed.

Establishment of FSDC

Few years back, an important addition was made to the regulatory architecture—the Financial Sector Development Council (FSDC) was set up which replaced the High Level Committee on Capital Markets. The council is convened by Ministry of Finance and does not have statutory authority—it is structured as a *council of regulators*—Finance Minister as chairman. It has a permanent secretariat.

The council resolves inter-agency disputes; look after the regulation of financial conglomerates that fall under various regulators' purview; and performs wealth management functions dealing with multiple products.

The *FSLRC* (Financial Sector Legislative Reforms Commission), set up (headed by Justice B. N. Srikrishna) to ***examine*** the regulatory structure and the laws governing the financial sector, submitted its report by early 2013. In a broad sense, the commission has recommended for changeover from an 'area-based' division of regulators to a 'task-based' division. Major highlights of the recommendations are as follows:

(i) Developing a 'horizontal structure' whereby, the basic regulatory/monitoring functions to be done by a UIA (Unified Financial Agency)—in place of each agency (like SEBI, IRDA, etc.) looking after one financial type and area. It will eliminate *regulatory overlap* (due to which the ULIP controversy happened between the SEBI and IRDA).

(ii) Setting up a FRA (Financial Redressal Agency) to handle consumer complaints, regardless of area. It means, regulator not to oversee the consumer complaints.

(iii) FSAT (Financial Sector Appellate Tribunal) to be set up to hear the appeals of entire financial sector.

(iv) Advice to set up three other agencies which will oversee banking, besides the RBI.

The advices of the commission are under government's consideration with some of them in the process of getting adopted, too.