Banking & Finance DIGEST

Issue No. 8 September 2011

INVESTOR AWARENESS & PROTECTION

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ABOUT FICCI

Established in 1927, FICCI is the largest and oldest apex business organisation in India. Its history is closely interwoven with India's struggle for independence and its subsequent emergence as one of the most rapidly growing economies globally. FICCI plays a leading role in policy debates that are at the forefront of social, economic and political change. Through its 400 professionals, FICCI is active in 39 sectors of the economy. FICCI's stand on policy issues is sought out by think tanks, governments and academia. Its publications are widely read for their in-depth research and policy prescriptions. FICCI has joint business councils with 79 countries around the world.

A non-government, not-for-profit organisation, FICCI is the voice of India's business and industry. FICCI has direct membership from the private as well as public sectors, including SMEs and MNCs, and an indirect membership of over 83,000 companies from regional chambers of commerce.

FICCI works closely with the government on policy issues, enhancing efficiency, competitiveness and expanding business opportunities for industry through a range of specialised services and global linkages. It also provides a platform for sector specific consensus building and networking.

Partnerships with countries across the world carry forward our initiatives in inclusive development, which encompass health, education, livelihood, governance, skill development, etc. FICCI serves as the first port of call for Indian industry and the international business community.

PREFACE

As we release the eighth issue of our widely acclaimed bi-monthly digest, it gives me immense pleasure to learn that since its inception in April 2010, in a short span of time, FICCI's 'Banking and Finance Digest' has gone a long way, in facilitating a comprehensive forum to promote active debate and raise pertinent issues that concern the who's who of the entire BFSI sector in the country. The issues discussed herein, over the past fiscal, have served valuable inputs for our extensive network of Industry members and stakeholders.

The issue of Investor Awareness and Protection has been one of the main focus areas for regulators, government and other stakeholders. The recent global financial crisis highlighted the importance of financial awareness and protection to shield investors from the consequences of market failure.

In the Indian context, developing markets and promoting Investor Awareness and Protection have always been high priority for the market regulators. However, despite considerable accomplishments, there is still a lot of unfinished work due to which liquidity and penetration in India's capital markets is significantly lower than expected.

Today, our financial markets, especially capital markets, are comparable with the best in the world in terms of systems and procedures. However, there is a yawning gap that exists at the retail level when it comes to understanding of financial products and knowledge of investor's rights. Promoting financial literacy and investor awareness remains critical to bridge this gap.

This issue of our journal aims to bring to the forefront perspectives of experts from Indian Inc. and financial sector intermediaries on 'Investor Awareness & Protection'. Eminent people from various segments of financial sector have expressed their views on role of Investor Awareness & Protection in making our financial markets more stable and inclusive.

We thank our partner MCX - Stock Exchange for extending their support to help achieve our endeavor.

We do look forward to views and suggestions from the readers to help us improve the content of the Digest and make it more relevant and informative.

Dr. Rajiv Kumar
Secretary General
FICCI

INDIAN CAPITAL MARKET: WHERE ARE THE INVESTORS, AWARENESS AND PROTECTION?

Joseph Massey, *MD & CEO*
MCX Stock Exchange

The economic relevance of a Capital Market lies in its effectiveness in performing successfully two basic functions: to facilitate resource raising from the community for financing corporate sector and government for various growth and developmental activities; and to provide an organized market place for the investors to freely buy and sell securities for investment and otherwise.

Patel Committee report on Stock Exchange Reform 1985 emphasized, the function of a stock exchange is to create conducive climate to an active primary market, to ensure fair and efficient trading in securities in the secondary market and to establish a harmonious relationship between the two. Similarly Pherwani Committee report on Establishment of New Stock Exchange, 1991 reiterate that the stock exchange is expected to facilitate the channelization of savings especially from the household sector to meet the investment requirements of the productive sectors of the economy primarily by ensuring a market place that provides liquidity to capital market instruments through fair and transparent trading practices.

Over the last two decades, the focus of Exchanges in being agencies to promote capital raising appears to have reduced

Table 1: Shying Investors from Equity Market

Period	Market Capitalization (BSE)	Average Daily Turnover in Equity segment of NSE and BSE	Average Daily Delivery (Approx)
2009-2010	61,64,157	22,610	5,050
2010-2011	68,36,878	18,375	5,040
April 2011	69,05,753	16,534	4,650
May 2011	67,29,515	13,320	3,840
June 2011	67,28,515	12,800	3,600

Values are in Rs Crore Source: NSE and BSE

despite significant positive developments in the regulatory and infrastructural support available. Exchange ecosystem has become more trading oriented as against being balanced between trading and capital raising. Exchanges have not caught up with changes required in the products profile, range of services, capital mobilization, cost of raising capital etc. This is more pronounced especially when compared with the developments in other emerging markets. We have somehow failed in creating an investment culture in capital market. India has just 19 million (1.6% of population) direct users of capital market as seen from the Depository accounts whereas China has 190 million (15% of population) users registered in their depository. Broad based market is always a national theme all over the world as more investor means more wealth creation and distribution in society facilitating better allocation of risk capital.

It is observed that even this limited participation of Investors is decreasing over recent past and it is clearly evident from the trading turnover reflected across NSE and BSE where the average daily turnover in Equity (cash) segment has dropped from Rs. 22,610 crore in 2009-10 to mere Rs 12,800 crore in June 2011. During the same period the market capitalization has increased by 9.3% (Rs 67 lakh crores), while the daily as well as delivery turnover have consistently shown in downward trend. Low investor participation is the result of various reasons which need correction.

The current distribution of Indian Capital market clearly depicts, the focus of the exchanges has been shifted towards the trading volume in derivatives. The growth in turnover in secondary market is also skewed towards cash settled and speculative instruments as observed in the current market turnover distribution. The delivered equity constitutes merely 2.9 percent compared to non-delivered equity trades of 7.5 percent, and cash settled derivatives trades of 89.6 percent as observed during June 2011. Increased derivatives transaction essentially indicates the growing interest for speculation rather than participation in the real capital formation within the country.

If the aim of the Capital Market was to boost economic growth by raising resources for productive sectors of the economy then certainly Indian Capital Market has deviated from the investment focus to speculation focus and the fear of further deviation of Indian Capital Market towards such speculative trading can't be ignored. Unfortunately, the

Table : Indian Capital Market (Turnover in Rs '000 Crores)

Turnover	Cash market (BSE+NSE)	Derivatives (F&O)
Jun 2011	282	2,438
Jun 2011 (in %)	10.4%	89.6%

technological advancement related to High Frequency Trading (HFT), is also favoring speculative trades compared with cash market transactions. The shift of focus of the market institutions - producing 'public goods' - from the market development to increasing 'top line' through turnover of the institutions, without being much concern about the long term economic growth of the industry and the consequent employment generation, is obviously damaging the very purpose of capital market.

In the process of over emphasizing focus on revenue and turnover and not quality of business and its economic utility, Market Institutions often do not communicate the associated Risks of financial products to the market participants (read mis-selling of financial products) which results in greater economical loss to common participants and the entire economy at large. The failure of much needed interest rate derivatives, both of short term (Treasury-Bill Futures) and long term instruments (10 years Government Securities) has huge impact on the fund raising ability of borrowers due to lack of liquidity. Even loss of this nature, due to failed/unavailable products, to the investors has direct or indirect impact on investors' protection. It is also a common fact today that the interest rate Derivatives are much needed in the global market but failed to take off in India in spite of two launches. Further, even after making cash settlement in recently introduced Treasury-Bill futures, the market interest is waning in this as reflected in the daily turnover coming down from Rs 700 crores to less than Rs 25 crores.

The investor protection in the Indian capital market is though up to Rs 10 lakhs through investor protection fund, in addition, the members default is taken care by the settlement guarantee funds maintained by the respective exchanges, it is still perceived lower than the depositor protection in the Indian banking system which offers protection up to only Rs One lakh (proposed to Rs 2 Lakh). The investor protection system of developed country as in the case of the USA (up to US$ 500,000; Rs 2.2 Crore approx), and in Canada (up to Canadian Dollar one million; Rs

Investor Protection in Various Countries	
Country	Investor Protection (Up to)
India	Rs 10,00,000
USA	US$ 500,000
Canada	CAD 1 Million

4.6 Crore approx) offers substantial protection to investors and also commands very high confidence amongst the investor communities. Further, in India while the protection is provided by Stock Exchange; in the US and Canada it is provided by the specialized government institution. It is time that in India too, we create an organization like, FINRA in US or IIROC in Canada to protect investors. The depositors in banks in India are protected by a government institution whereas Stock Exchanges are private and so do not enjoy as much confidence of Investors. Lastly, it is important that we have a wide investor base to create critical mass for various products and services. This in the short run is possible if each bank promotes a broking company and start providing capital market services to its depositors.

Joseph Massey
MD & CEO
MCX Stock Exchange

Mr. Joseph Massey is the MD & CEO of MCX Stock Exchange (MCX-SX). He is instrumental in formulating and implementing policies, procedures and best practices at MCX-SX, besides overseeing strategic operations and overall functioning of the exchange. Prior to MCX-SX, he was heading the operations of Multi Commodity Exchange of India.

Mr. Massey has over 20 years of diverse corporate experience and had stints at leading financial organisations such as Life Insurance Corporation of India, the Reserve Bank of India, Stock Holding Corporation of India, and the Vadodara Stock Exchange. Before joining MCX, he was the head of Interconnected Stock Exchange of India — a collaboration of 15 regional stock exchanges.

Mr. Massey is widely travelled and gains his rich experience from his visits to the world's top exchanges such as NYMEX, LME, CBOT, CME, NYBOT, CCX, EURONEXT-LIFFE, IPE, NYSE, NASDAQ, Philadelphia Stock Exchange, SEC, CFTC, LSE, Singapore Stock Exchange and DTC. He has also been a part of various committees of FMC, SEBI and the Government of India on various policy issues pertaining to commodities and securities market. He is also currently the chairman of South Asian Federation of Exchanges (SAFE), a regional forum of exchanges and regulated entities.

FINANCIAL EDUCATION AND CONSUMER PROTECTION

Vivek Kudva
Managing Director India and CEEMEA
Franklin Templeton Investments

Over the last few decades, the global economy has witnessed the emergence of developing economies, increased global integration and financial innovation. All these factors along with technological innovation (internet/electronic movement of money) had helped the global economy grow at a reasonable pace. Fast growth in emerging market countries like India in the last decade resulted in increased demand for goods and services, including financial services - a World Bank report estimated that 150 million new consumers of financial services were being added across the world each year, until the global financial crisis.

The crisis has highlighted the importance of financial literacy and an appropriate framework for investor protection, and there has been a push for increased regulatory reform. At the same time, the key point is not to stifle financial innovation, but to ensure that investors are given adequate information and have the ability to assess investment risk as well as press for recourse. Hence, financial literacy and protection through regulation are intrinsically linked. Addressing this has become important for sustainable long term economic growth and financial stability, especially in fast growing countries like India.

While increasing income levels and growing demand for financial services amidst heightened competition had led to constant financial innovation in order to meet the varied needs of investors, increasing complexity of the products combined with relatively lower financial literacy levels in emerging market countries like India meant that a large number of households have difficulty in understanding the range of products choices as well as the risks and obligations that they assume.

Given India's young and growing population, future generations are likely to be more comfortable with market-linked financial products (unlike their parents who used to look at traditional/conservative savings products). In such a scenario, it is imperative that the government and the financial services industry work together to ensure that investors buy financial products after matching their expectations with reality, which will help in building a satisfied investor base, who can deal with the ups and downs of the financial markets. This also means that advisors are well trained and fully equipped to guide investors in the right manner.

Financial Services in India

India's GDP is expected to witness continued growth and is expected to reach US$ 6 trillion by 2025, while the cumulative savings flow is expected to touch US$ 10 trillion[1] . This presents a substantial opportunity in expanding the financial services canvas amongst retail investors. The government has been rightly focusing on inclusive growth given that majority of the country's population is estimated to have been excluded in terms of formal financial services. Hence, before we talk about increasing retail penetration beyond the cities, we need to keep in mind that access to basic financial services is currently limited and needs to be addressed.

This is also reflected in the fact that today, physical savings in India account for over 50% of the household savings[2] and financial services penetration is very low. Despite the strong growth witnessed in recent years, the share of mutual fund assets as a percentage of total GDP remains low compared to developed markets - about 14% in India compared to around 70% in the US. Even if we look at penetration of other financial products such as

insurance, mortgage and pension, they all have relatively lower reach compared to key emerging and developed markets.

A combination of financial awareness and possible mis-selling has impacted investor trust in financial products over the years, especially during periods of increased market volatility. We have to ensure that this is avoided to realize the full long term potential for financial services.

Investor Protection - Potential Framework

Effective investor protection and adequate financial awareness can help in making the retail financial markets efficient and transparent, thereby enhancing the depth of the markets as well. An effective investor protection framework needs to ensure that -

[1]*Source : Kotak Institutional Equities*

[2]*Source : RBI*

- There is no imbalance of information and knowledge - adequate and plain disclosures
- Financial institutions are not allowed to engage in unfair practices.
- There is a clear framework covering investor rights and dispute resolution mechanisms
- Regulations do not stifle industries - if the business does not make basic commercial sense, institutions will stop providing the service. This in turn impacts long term investor interests.
- Privacy of data is protected.
- Makes the distinction between professional/sophisticated investors and retail investors - as the complexity of the product and suitability could vary.

Apart from the above, the effectiveness of any investor protection framework is dependent to a great extent on financial awareness and hence, the government/policy makers need to focus on both aspects.

Using the above framework as a potential benchmark, Indian markets and industries are well regulated with high disclosure norms and clear policies.

However, Indian policies would fail on some of the above mentioned factors in terms of a clear regulatory framework for intermediaries.

Measures taken by SEBI like recent listing regulations have balanced the interests of minority shareholders with those of promoters intending to delist companies. It has also offered guidelines for enhanced disclosures and mandatory grading of Initial Public Offerings (IPOs). The regulator is also mulling safeguards relating to the power of attorney that investors sign in favour of brokers. There are also several initiatives being taken by the government like setting up the Investor awareness and Protection Fund and increased regulatory focus on investor protection.

While there have been some efforts to regulate the intermediaries, a lot more can be done by looking at various practices across the globe. Many countries including Canada, Singapore and South Africa have governance mechanisms for financial advisors.

- South Africa has established the Financial Advisory and Intermediary Act which enables consumers to seek redressal in case they have been mis-led or mis-represented by the advisor.
- In Malaysia, financial advisors/planners require a license and SROs like Malaysia Financial Planning Council and the Financial Planning Association of Malaysia, enable the Registered Financial Planner (RFP) programme and

do the monitoring. There are separate programmes for Shariah advisory as well.

Also developed markets have different level of certifications based on the type of financial product being distributed. While ideally financial advisor qualifications or certification would help in ensuring uniform standards, one should also keep in mind that evolving industries like those in India need to expand reach. In that sense, any certification process should not become cumbersome and impact distributors.

Financial Literacy

Increasing financial awareness in a large and diverse country like India will have to be a long term effort that is built on a private-public partnership basis and involves all financial sector players. A clear national strategy needs to be developed and we can look various initiatives proposed by the Swarup Panel including FINWEB. Before we start on any of the programmes, a baseline survey needs to be done to be able to measure the progress of the various initiatives taken to date.

Given India's diversity and literacy levels, the programme needs to be able to clearly address regional language needs and include visual aids. More importantly, the language and concepts need to be simplified extensively. Also given the growing percentage of younger population, the medium used needs to be relevant - internet, social media and mobile. The potential programmes can include -

- Introduction of financial basics, concepts and planning courses in all schools/colleges
- Seminars/Workshops across the country
- Television ads talking about investing and not just saving
- Television shows - especially in regional media
- Involve print media for allocation of dedicated space for financial education.
- Have targeted programmes for Women and Children
- Audio-Visual aids in multiple languages and simple animations - can be part of a national website
- Emphasis on basic concepts such as compounding, asset class returns, impact of inflation, tax and the need
- MFIs, self-help groups and other financial institutes with presence in smaller locations and providing services to the under-privileged might be critical to enhance reach

From the manufacturers' perspective, they can make a distinction in their communication and literature between mass retail and high end/institutional investors. This process also needs

to ensure that advisors are well trained and equipped to guide investors through the ups and downs of financial markets.

Summing Up

While we can draw upon global best practices for building policies for investor protection and awareness, it is important to keep in mind the diversity and uniqueness of India. Financial Literacy and Investor Protection are clearly intertwined and any efforts to enhance them needs to be a holistic process that takes into consideration investor interests as well the need to develop and grow the industry. A well informed and fully aware investor base is important for a growing economy like India, as it fosters financial stability with expectations aligned with market realities. This will help financial service providers to cater to the financial needs of investors and divert their savings to productive sectors of the economy.

Vivek Kudva
Managing Director India and CEEMEA
Franklin Templeton Investments

Vivek Kudva is Managing Director for India and CEEMEA. In this capacity, he is responsible for providing strategic direction and leadership to the firm's businesses in India and CEEMEA. He is based in Mumbai.

Prior to joining Franklin Templeton, Mr. Kudva was General Manager of Banking with National Bank of Oman, Muscat. Before this, he was with Hongkong & Shanghai Banking Corporation (HSBC) for over 18 years. He has extensive commercial banking experience and was Head of Personal Financial Services, India, in his last assignment with HSBC. He was instrumental in successfully developing and executing the bank's retail growth strategy in India.

Mr. Kudva is an engineering graduate from the Indian Institute of Technology (IIT) Delhi, India, and has a post graduate diploma in management from the Indian Institute of Management Ahmedabad (IIMA), India. He enjoys traveling and playing bridge and golf.

INVESTOR AWARENESS AND PROTECTION

Jaideep Bhattacharya, *Group President & Chief Marketing Officer*
UTI AMC Ltd

"The greatest obstacle to discovery is not ignorance but illusion of knowledge"

The unknown unknown

There are known knowns. These are things we know that we know. There are known unknowns. These are things that we know we don't know. But there are also unknown unknowns. These are things we do not know we don't know. Investment is one such area where we mistake familiarity with in-depth knowledge. Most of us have an illusion of knowledge with regard to investment. Lot need to be done with regard to investor education in order to enhance the knowledge and increase the awareness.

Need for Investor awareness about financial planning

Why has financial planning and the awareness regarding the same has been given stress of late? True, the need to plan your resources for optimal utilization during the winter of your life has always been there. What has changed

-the increasing life span,

-the family structure - from joint family to nucleus

-pension from defined benefit to defined contribution and

- investment choices from simple to varied and complex.

There is a paradigm shift in financial planning over the years

from "What if I die" to "What if I live".

Investor awareness in India

Research has established links between financial literacy and household savings and have brought to light the fact that lack of financial literacy make people under -save for their retirement, take poor decisions and experience other problems in this complex financial environment leading to not achieving their financial goals. Investor awareness include not only the knowledge of various financial products available but also facilitate decision particularly among the less educated as well as those investors committed to long term financial decisions. This will enable investors to shape their retirement planning better. OECD research19 shows that a financially literate population promotes economic growth and

well-being by expanding the quality of available financial services, and by enhancing the ability of individuals to more effectively use the services in their best interests.

With a household saving rate of over 30 per cent22, India understands the merits of saving over current consumption. Unlike much of the west, where getting people to save is an issue, the bottleneck for India is the efficient conversion of this saving into investment. A large part of this money is in low-yielding assets like bank deposits and traditional insurance23, but there is a clear trend24 of individuals preferring security based investments as they go up the income ladder.

Advertising and the agent network have worked positively to create awareness, but not knowledge. A coordinated approach is needed to convert this awareness into knowledge. The Reserve Bank of India (RBI) has taken a lead in the financial literacy space, and its efforts are mainly in the banking space. The Ministry of Corporate Affairs too has programmes on the ground, including the setting up of the Investor Education and Protection Fund (IEPF), and this is mainly in the securities market space.

However, for the consumer, there is need for a holistic approach.While buying a product, they need to have a big-picture view of their portfolio and how diversified it is rather than individual pieces of information regarding the products. . The rural consumer possibly needs the literacy effort even more urgently, though at a different scale and content level. While more than 80 per cent of the agricultural wage labour is still unbanked28, due to reasons of location, society, caste, religion and poverty, micro-finance institutions have been able to reach 86 million29 of the poorest Indians (80 per cent being women) with tiny loans.

The committee on Investor awareness and protection in its consultative paper opines:

A review of most current financial education initiatives show that they are largely in the linear, structured space, where teaching is around defining a stock market, a mutual fund, a bank and so on. Could non-linear, concept- and utility-based learning work better in financial education? Recent academic work in financial education from the US33 shows that utility-based learning is more useful in changing behaviour. Unless the recipients of financial education are clear about how this material and training will help them, and they are able to connect it to what they are doing in their lives, the retention is usually very low. Merely learning the structure of a market or how a mutual fund works is alienating.

It is quickly forgotten once the class is over. The other reason for taking a concept-centric route is that constant innovation in the financial sector means that by the time the knowledge and understanding of a new type of a product trickles down, it is already outdated.

To sum up, the success in investor awareness campaign lies in making investors realize that they do not know what the future holds and hence diversifying across various assets and investing within the limits rather than venturing beyond.

Jaideep Bhattacharya
Group President &
Chief Marketing Officer
UTI AMC Ltd

Shri Bhattacharya is working as Group President & Chief Marketing Officer in UTI Asset Management Co. Ltd. (UTI AMC), overseeing functions of Sales & Marketing.

Mr. Jaideep Bhattacharya is a Post Graduate in Economics. He has more than 22 years of work experience with over 17 years in financial sector. He has vast experience in Banking, Products, Channels and Marketing of financial services. He has earlier worked with Foreign Banks and Private Banks in various capacities. Before joining UTI AMC, he was the Country Head of the largest Private Sector Bank, in-charge of Products, Channels and Marketing for the Small and Medium Enterprise Group. He was designated as a Director in the Board of AMFI from 2007 to 2010. He was also a member of SEBI - Advisory Committee of Mutual Funds between 2008 and 2010. He was awarded the "Marketing Personality of the Year - Asia" by Asia Asset Management in 2010. He was also awarded MYKM Stars of Industry "Youth Icon Award" from 94.3 Radio FM.

INVESTOR AWARENESS & PROTECTION – CHALLENGES AND THE WAY FORWARD

Nimesh Shah, Managing Director & Chief Executive Officer
ICICI Prudential AMC

As an economy evolves and the financial system becomes more sophisticated, the choices available to the investors increase manifold. Rising competition, new products and a search for better solutions widens the array of options that can be exercised. This expansion in the bouquet of options available brings its own set of issues to be addressed, especially when it comes to a subject as sensitive and personal as money. Over the last decade, Indian financial markets and mutual funds in specific have gone through a similar phase. While the consumer has benefited vastly in this new age, the need for education and awareness has become equally acute. This is true for all the areas of financial services including banking, insurance, mutual funds and retail credit.

Investor awareness and education has gained considerable importance from the perspective of the regulator, investor as well as the financial services companies. The notion that investor education is a joint responsibility and good for the business at large is now gaining ground. While the regulators constantly look for ways in which the consumers can be reached out, the private players have started investing in surveys, seminars, tutoring programs etc. And the spirit behind such initiatives is not that of making instant gains, but to play a role in the wholistic growth of the industry. The challenges faced while trying to educate customers in financial services are apparently quite different as compared to the other industries such as consumer goods.

Investor awareness – the key challenges

Diversity and the need for customization

The first important differentiator lies in the diversity of customers and their needs. This is relevant in any society, but more so in a pluralistic society likes ours. The permutations can be too confusing to prepare a “fit for all” message. Indian investors vary not only in terms of languages, cultural predispositions and general literacy; but they also bring the challenges of different socio economic sections, risk appetites, past experiences and attitudes. It is important to realize that India is not as urbanized as it might appear to private enterprises. Educating about personal finances is not easy because the communication needs to target this perplexing heterogeneity.

Getting reliable information

The next hurdle to be managed is that of an inadequate and sometimes misleading data to be effective. Even today at least in India, the subject of personal wealth and income is perceived to be a family matter. The need for counseling and planning through various products and services is generally not recognized. The general learning from the experiences of primary researchers indicates that people are comfortable answering questions on personal consumption, but not on personal financial condition. In our society, it appears that money is still seen as a closely guarded possession and not a means to comfortable living. The things are thankfully changing for better now. With the rise of a salaried middle class, penetration of credit and banking, emergence of mutual funds and a general drift towards transparency the things are getting better. With a greater availability of information, communication can be bilateral and solutions more bespoke.

The need for personal discipline

Unlike in the other kinds of products and services, solutions cannot be administered in the area of money and finance. In fact here you have plans to be executed, products to be slotted as per the plan and most importantly habits and paradigms to be changed. Investor awareness is therefore a continuous process of engagement and not a one-time exercise. Even the best laid plans will only remain on paper unless they are adhered to with discipline and focus. This may sound like a platitude, but the factors that impact financial behavior include intrinsic as well as extrinsic factors. Masses are generally fallible and do get drawn towards fads, quick solutions and so called "attractive" schemes.

Conventional, simple and time tested principles are not easy to propagate due to a lack of novelty.

Legal and regulatory sophistication

Financial services are regulated tightly in every economy of the world. Obviously, the idea is to evolve an ecosystem of trust such that people repose supreme faith in the various stakeholders participating within the financial system. The regulations are necessary and inevitable, but they also bring an element of sophistication that adds to the task of understanding. This, along with a taxation system that is studded with a maze of exemptions, provisions and amendments complicates the matter for a layman. There is a need to address these issues with simplicity and in an effective manner.

The way ahead

Investor education is the first and necessary step towards investor protection. Indian investors are good savers, but often lose hard-earned money due to lack of knowledge and understanding about financial markets and financial products. It is a widely accepted fact in the asset management industry that mutual funds in India are 'sold' and not 'bought'. These products need a 'push' to reach investors, at least in the non-metro areas. The distribution and its growth is necessary to serve this vast population. At the same time, the industry also needs to guard against the mis-selling of mutual funds, and take suitable preventive measures.

Sometimes mis-selling may also happen inadvertently, if the distributor does not have the relevant expertise to guide the investor. Training and constant upgradation of skills among the distributors is the key. This is because the Indian mutual fund industry is going through a transitory phase with multiple developments in the areas of distribution, taxation and other regulations and compliance

standards. The main objective of fund houses is to continuously increase participation from investors.

Given the priority accorded to it, there are multiple ways to deal with it in a collaborative spirit. To have sustainable growth, it is critical that the investor understands the product, has a long-term financial plan in mind and is equipped with the right kind of products that fulfils his/her requirements. Investor education programs have been a step towards educating the investor, but the industry still has a long way to go.

A step in this direction has been taken by the mutual fund industry's trade body AMFI of running television commercials to educate people about the benefits of investing in mutual funds. The idea of running ad campaigns was mooted by the industry sometime back but has taken shape only recently.

The money for running these campaigns will be sourced from the unclaimed dividend accounts of asset management companies which are parked in Investor Education and Protection Fund. SEBI had put up a discussion paper on the Investor Protection Fund (IPF) in March 2008. The

draft paper of Securities and Exchange Board of India (Investors Protection and Education Fund) Regulations, 2008 stipulates that the funds are meant to be used for investor education through media, conduct research and other investor awareness and empowerment activities. AMCs disclose 'Unclaimed redemption proceeds' and 'Unclaimed Dividends' in their balance sheets on a half yearly basis. It will be a good initiative to create awareness about what a mutual fund is and its benefits.

Some of the other ways in which greater awareness about mutual funds is being brought include organizing investor meets, using multiple vernaculars, aided by the technology of mobile phones, use of advanced business models etc. Extensive investor campaigns are being rolled out by fund houses to educate the investor about the various schemes and build an understanding of investment options over the short term as well as the long term. These campaigns and programs are designed to aid the investor in formulating his investment goal and planning to achieve it over a defined time horizon. Concepts of financial planning are introduced and newer opportunities are being created to distribute mutual funds in the rural and semi-urban areas.

Having said this, it is just not enough to educate investors and create awareness. In these times of uncertainty and high volatility, it is equally vital that advisors and agents are transparent in their dealings and impart all necessary and relevant details to the investor, to help him make an informed investment decision. For mutual funds to gain popularity, it is important for advisors to cultivate the faith of the investors on a continuous basis. Transparent and flexible products, simplified documentation procedures and relatively low cost and size of initial investments, are some of the aspects which can make mutual funds an attractive proposition for the uninitiated.

Educating the customer will also make the customer capable of making an informed investment decision and strategize his long-term investment plan. Building an understanding of the mutual fund product, and outlining the risk attached will help the customer to put his money in the right pockets. It will also help the investors to take the necessary precautions while dealing with market intermediaries, so that they are not waylaid in any manner. An ecosystem of trust between the mutual fund, the distributor and the investor will allow this industry to reach the potential it promises. And developing this requires a concerted focus on each link of this chain.

Nimesh Shah
Managing Director
ICICI Prudential AMC

Nimesh Shah joined ICICI Prudential AMC as its Managing Director in July 2007.

Nimesh has completed his Chartered Accountancy. Prior to joining ICICI Prudential AMC, Nimesh was Senior General Manager at ICICI Bank and has over 18 years experience in banking and financial services. At ICICI Group, he has handled many responsibilities including project finance, corporate banking and international banking.

He was associated with one of the first batches of senior managers selected to lead the foray of ICICI Bank into the international arena. He led ICICI Bank's foray into the Middle-Eastern region and Africa.

INVESTOR PROTECTION: THE POWER OF KNOWLEDGE

Mythili Bhusnurmath, *Consulting Editor*
Economic Times
NR Bhusnurmath, *Professor of Finance, MDI Gurgaon*

The best form of investor protection is investor awareness and the best way to achieve that is through financial literacy.

Scarcely a day goes by without our hearing some reference or other to financial inclusion. Unfortunately the same cannot be said about its twin, financial literacy! Yet it is financial literacy that holds the key to financial empowerment and without the latter all talk of financial inclusion is meaningless.

Mugeri Lal needs access to financial services. But once he gets that access, he also needs to be protected; not from losses that are a natural consequence of developments in the market but from losses that arise from his ignorance or lack of familiarity with financial products. This is where financial literacy comes in. In a market-driven economy, investor protection is best ensured by competition between players, effective regulation, and no less important, financially literate investors.

Financial literacy, as the name suggests, means being familiar with and understanding financial market products, especially rewards and risks, in order to make informed choices. Contrary to widespread belief, financial literacy is important not only from the perspective of individual investors but is also an important public good since a watchful public acts as the eyes and ears of formal regulatory bodies reducing the need for tax-funded bailouts. The collapse of many 401K plans in the US in the aftermath of the financial crisis, for instance, might have never have happened had investors in these plans kept a more watchful eye on their investments.

Speaking at a recent workshop on Financial Literacy organised by the Reserve Bank of India (RBI) in co-operation with the OECD (Organization for Economic Co-operation and Development) the governor of the RBI, D Subbarao pointed out that the goal is not only to impart knowledge but to change behavior. The objective is 'to empower people to take actions that are in their own self-interest.'

Financial education helps consumers know enough to demand accountability and seek redressal of grievances. This in turn, enhances the integrity and quality of financial markets. 'Financial literacy', said the governor, 'is not just a public good, but also a merit good'.

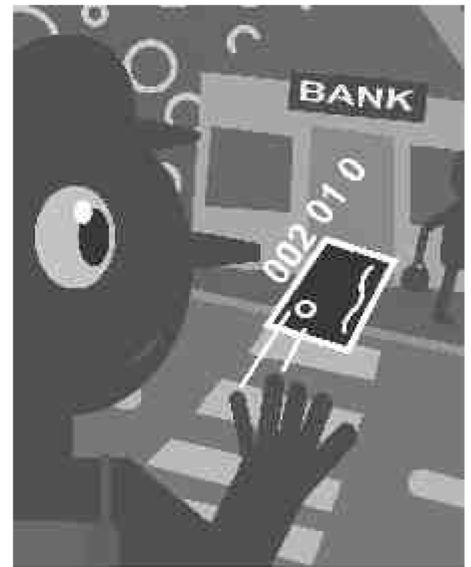
In a country like India where the general literacy rate is just about 60%, any talk of financial literacy might seem downright premature if not wishful thinking altogether. More so when the reality is that investment in financial instruments is often based on a tip here, a whisper there; it is seldom on a full understanding of the product in question.

The risks associated with such mindless investment may not be high as long as it is in safe avenues such as bank deposits, post-office deposits or government bonds. But when it comes to investment in stock market instruments that are subject to market risk, it is another matter altogether. Here there is no substitute for detailed reading of the prospectus/study of the company/industry, some basic understanding of financial statements etc, something few retail investors are equipped to do.

Things are no different when it comes to other financial products, like insurance or pension products. It is this realisation that has spurred the government and financial sector regulators to join hands to increase financial literacy.

Almost four years ago the government (ministry of corporate affairs) declared September 2007 'Investor Awareness Month'. During the month a number of activities were organised to promote financial literacy and investor awareness. The aim was to help bridge the yawning gap that exists at the retail level when it comes to awareness and understanding of financial products.

These efforts have been supplemented by efforts such as the RBI's Project Financial Literacy



aimed at increasing awareness and knowledge of financial products. The Securities and Exchange Board of India (Sebi), the Insurance Regulatory and Development Authority (IRDA) and the Pension Fund Regulatory and Development Authority (PFRDA) have their own Investor Education Programmes, all aimed at promoting familiarity with distinct financial products.

The objective is not entirely altruistic. We need to mobilise savings if we are to meet our gargantuan development needs, $ 5 trillion for infrastructure alone in the next five years, according to the Prime Minister, Dr Manmohan Singh.

Today our financial markets, especially capital markets, are comparable with the best in the world in terms of systems and

procedures. Regulation may not be quite as top-of-the-league as we might wish but by and large we can say, with justifiable pride, that our markets are world-class. Overseas investors have already vouched as much going by the quantum of money foreign institutional investors (FIIs) have poured into our stock markets since investment in shares was opened up to overseas entities. Unfortunately, their confidence is not matched by domestic investors, particularly retail investors, many of who remain deeply suspicious of investment in equities.

The net result is that not only does saving in financial instruments account for only about 50% of total household savings, capital market instruments accounts for only a relatively small share (1.4%) of financial savings. In contrast, bank deposits account for close to 56% of household financial savings. This is no doubt a reflection of the greater safety in bank deposits in a scenario where a major part of the banking sector is state-owned, bank deposits are covered by deposit insurance and large banks are not allowed to fail.

However, a growing economy needs not only a sound banking system but also a vibrant capital market, a thriving insurance market and an active market for pension products to mobilise resources for development. None of this can happen unless the public is enthused, either directly or indirectly through agencies like mutual funds to invest in financial products, rather than in physical assets like gold and silver.

Research findings show savings in financial investments give a much higher return than in physical assets, apart of course, from greater convenience and easier liquidity. Most research would also suggest that over the long term investment in stocks gives a higher return than in bank deposits. Despite this both physical assets and bank deposits retain their powerful hold on the Indian psyche. Why?

To a large extent the answer is because individuals are not financially literate and hence are either hesitant to invest in products they don't understand or are unable to make informed decisions and as a consequence burn their fingers. Collective investment schemes, plantation schemes and other get-rich-quick schemes seem to have no dearth of takers and given our slow and tardy legal process, investors are often left with no recourse but to lick their wounds in silence.

Partly as a reaction to investor naivete, regulators tend to frown upon all but plain vanilla products, in the process depriving investors of a range of choices that might better suit their requirements.

For instance, the last two years of the State Bank of India's (SBI) erstwhile Chairman, OP Bhatt's tenure at the helm saw a running battle between him and the Reserve Bank of India (RBI) over teaser home loans. These are loans where the interest rate is fixed at an attractive rate for an initial pre-determined period after which the rate ceases to be fixed and becomes a floating rate. The RBI was apprehensive naïve borrowers with limited understanding of how interest rates work in the real world would be seduced into taking loans that they could not afford to service.

Its fears were not entirely unwarranted - the sub-prime crisis in the US was partly driven by borrowers taking loans (mortgages) that they could not repay once interest rates reversed. If sufficiently large numbers of borrowers default, banks also suffer. And if, as happened during the financial crisis, such losses become excessive, then at some stage taxpayers too will suffer (when

taxpayer money is used to bail out banks). So there is a potential systemic risk that the RBI as banking sector regulator is entirely right to guard against.

But that is true of all loans, not only teaser loans. The only reason why extra caution is warranted in the context of teaser loans is because they entice borrowers into taking loans as they appear very cheap; never mind they might prove very costly some years hence. Consequently, there is the possibility that many borrowers who do not have the wherewithal to service their loans might be tempted to borrow, nonetheless. The same could be said about credit cards as well: they promote consumerism and though that in itself is not a bad thing, it could be catastrophic if people do not understand the power of compounding and how a seemingly low rate of interest on a daily basis can actually translate into a usurious annual rate of interest.

The solution, however, is not to interfere in pricing decisions of banks by forcing them to withdraw attractive products, whether teaser loans or credit cards, but to insist on a number of other things. One, of course, is ensure more transparency so that people know what they are getting into; for instance banks can be told to incorporate an illustrative example in the loan document/credit card application so that the implications of compounding and of floating rates of interest become plain to customers. The second no less important thing is to encourage financial literacy so that customers cannot be taken for a ride so easily. Instead the RBI's insistence on withdrawal of teaser loans deprived customers of an option they might have liked to exercise.

Likewise, a few years ago the insurance regulator IRDA banned the sale of complex actuarially-funded unit-linked products apprehending that these were too complicated for a market like India where few understand the difference even between term insurance and investment-linked insurance. Fearing that unscrupulous companies may take investors for a ride, the regulator preferred to ban them altogether.

The bottomline is there is no alternative to financial literacy. It increases choices, makes for more informed choices and acts as a bulwark against larger systemic risks. However it is important to draw a line under this for even with the very best financial literacy, investment can never be entirely risk-free. Financially-literate investors recognise this and act accordingly; financially-uninformed investors don't. There lies the difference!

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INVESTOR AWARENESS AND PROTECTION

Naresh Takkar
ICRA Limited

A well functioning capital market must necessarily have adequate safeguards for investors, especially the retail investor.

It is well known that retail participation in the Indian markets leaves a lot to be desired. It is estimated that retail participation in the Indian stock market declined from 20 million in the 1990s to 12 million in 1999, and further to just around 8 million in 2009. As a percentage of the total population, retail investor participation in India stands at a mere 1.3%, against 27.7% in the US and 10.5% in China, according to the Bimal Jalan Committee report. On the mutual fund side too, the number of folios (investor accounts), according to some reports, has shrunk to 3.8 Crore in March 2011, from above 4 crore in March 2009.

On an average, Indian households invest their cumulative savings of over US$65 billion annually in bank deposits. In the Indian context, in which a large part of the savings originates from the household sector, this is a serious drawback.

There are several reasons for this apathy towards the capital markets. The first and foremost is possibly disillusionment with the type of returns one has actually made on the stock markets, given that participation typically picks up at the peak of the cycle. When the cycle turns, investors sit on large losses. The experience with most IPOs has also been similar. During good times, merchant bankers and promoters seeking to maximise the value of their holdings are seen to be leaving very little on the table for investors. The second reason is the number of scams that has hit the market since the early 1990s.

This has eroded the faith of the average investor in the capability of the existing institutional mechanisms to safeguard their interests. The third factor is possibly the absence of reliable and credible investment advisors, who can provide unbiased and sound investment advice. The mis-selling that was rampant in the case of ULIPs illustrates this point most tellingly. In addition, there are several procedural issues, like difficulties in opening a demat account and cumbersome

KYC procedures, that serve to discourage the retail investor.

While each of the problems highlighted has different characteristics, and possibly different solutions, the one theme that no solution can overlook is possibly the critical importance of "Investor Awareness and Protection".

The market regulator, the Securities and Exchange Board of India (SEBI), has been at the forefront of promoting the cause of investor awareness and protection.

Accordingly, SEBI has been endeavouring consistently to promote a market that is both efficient and fair, and also one that protects the investor rights. Modernisation of the market infrastructure (to increase market transparency) and improvement of the market microstructure (to raise trading efficiency) have been among the key focus areas for the regulator. The other area of emphasis has been risk containment, which improves market integrity and credibility. Measures like compulsory grading of IPOs by rating agencies and abolition of entry loads on mutual fund investments are also steps that have been taken to further the cause of investor protection.

Apart from SEBI, another major entity promoting the cause of investor protection has been the Investor Education and Protection Fund (IEPF), managed by the Ministry of Corporate Affairs. The IEPF's activities include educating and creating awareness among investors through seminars and the media, and funding investor education, awareness and protection projects.

Given the large investor participation in insurance products, which is expected to increase several times once the New Pension System (NPS) gets wider acceptance, the Pension Fund Regulatory and Development Authority (PFRDA) has also been promoting the cause of investor protection. Further, the Association of Mutual Funds in India (AMFI) has been conducting several investor awareness programmes to educate investors.

While a lot of progress has been made on several fronts, there are certain areas that the regulators and other stakeholders are currently focusing on, as the following bullet list discusses in brief:

- Investor education campaigns: The regulators, stock exchanges and the media are making efforts to educate investors about intricacies of the securities market. Workshops are conducted at regular intervals with the participation of market participants, market intermediaries, investor associations, and such other entities. However, it is felt that the scope and frequency of these programmes need to be increased significantly. Also, a coordinated approach should be adopted, so that a prospective investor gets a

holistic view of the various financial products that are available, the attendant risks and the likely returns.

- Common standards for financial advisers: As the PFRDA discussion paper on "Minimum Common Standards for Financial Advisers" pointed out, there are nearly 3 million financial advisers [2009 figure] selling non-banking financial products in India. The figure includes individual agents selling mutual funds and insurance, financial advisers, financial planners, bank employees, and direct selling agents from banks. There is a pressing need to ensure that selling is not based merely on the incentive structure that the product offers, and there are proper qualifying criteria that are laid down for all such advisors.
- Grievance redressal mechanism: The system of handling and redressing grievances needs to be strengthened so that investors have an effective and functioning redressal system., and investor apprehensions are minimised
- Strengthening corporate governance standards: SEBI and the Government have, over the last few years, taken several steps to improve the corporate governance standards prevailing in the country amongst the listed companies. The areas covered include, among others, composition of a company's Board of Directors and the proportion of independent directors; composition of the audit committee of the Board, the minimum professional qualifications of the members of the audit committee; and appointment of statutory auditors. While it is not clear as to the weightage the investor accords to governance practices, the steps taken are significant, having been designed specifically to ensure confidence among investors about the integrity of a company's accounts and disclosures.

- Increased transparency and disclosures for complex products: With sophistication in the capital markets increasing, more and more complex products are being designed and brought into the market. While these products may not be meant for retail investors, it is important that disclosures on the risk factors involved be adequate.

In the context of investor protection, rating agencies, which are an important constituent of the financial market, also have a key role to play. The core function of any rating agency, like ICRA, is to assess the creditworthiness of debt instruments and rank them on a relative rating scale. Thus, a rating assigned byICRA would be a symbolic indicator of ICRA's current opinion on the relative capability of the corporate entity concerned to ensure timely servicing of debt and obligations, with reference to the instrument rated. Rating assigned by rating agencies are based on an objective and rigorous analysis of various factors that can impact the rated company's debt servicing ability.

It is well known that secondary debt market in India remains rather limited in terms of both issuances and trading . It is equally well understood that an efficient and active debt market, particularly in long-term private debt instruments, is essential for the country to realise the full benefits of the economic reforms process that it has initiated since 1991 and to achieve its growth potential. As the market develops, credit ratings would have an increasingly important role to play in assisting investors evaluate credit risks.

While on the subject of ratings, it would perhaps be pertinent to take up two non-credit-rating products-IPO Grading and Corporate Governance Rating-and examine how these products contribute to investor protection.

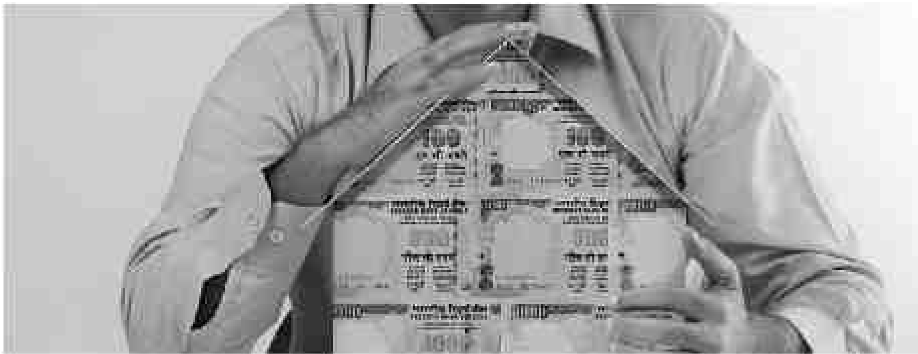
IPO Gradings: ICRA's Grading of IPOs is a service aimed at evaluating the fundamentals of equity issues offered to the public. The Grade assigned to any individual IPO is a symbolic representation of ICRA's assessment of the "fundamentals" of the issuer concerned on a relative grading scale.

An IPO Grade provides an additional input to investors in arriving at an investment decision based on independent and objective analysis. In recent times, with the stock market participation of new and foreign investors increasing, there is need for greater value-added information on companies tapping the capital market and their intrinsic quality. In this context, IPO Grades, being simple, objective indicators of the relative fundamental positions of the issuers concerned, could help in both widening and deepening the market. However, an ICRA IPO Grade does not comment on the valuation or pricing of the issue that has been Graded, nor does it seek to indicate the likely returns to shareholders from subscribing to the IPO.

Corporate Governance Rating: A Corporate Governance Rating (CGR) indicates the relative level to which an organisation accepts and follows the codes and guidelines of corporate governance practices. The emphasis of the CGR process is on evaluating the corporate entity's business practices and quality of disclosure standards that address the requirements of

the regulators and are fair and transparent for its financial stakeholders.

By looking at an ICRA-assigned CGR, a financial stakeholder can get an idea of the level of corporate governance practices followed by the company on a relative scale. In simple terms, it would imply things like how sound the Board practices are, how transparent the company is while communicating with its stakeholders, how fair it is in protecting the interests of the minority shareholders, and so on. At the same time, a good CGR does not mean that the company in question is protected from business risks or that its financial performance will not fluctuate from year to year.



Conclusion

To sum up, increasing retail participation is a must for the proper functioning of both the debt and equity markets in the country . While the regulators and the Government have taken a series of steps to increase investor awareness and also safeguard the interests of investors, retail participation in the markets still remains muted. In this context, rating agencies, by providing independent, credible and unbiased opinions on companies issuing debt securities or raising money through IPOs, have an important role to play in assisting investors gauge credit risks and the fundamentals of issuers.

INVESTOR AWARENESS AND PROTECTION: THE CREDIT RATINGS PERSPECTIVE

D R Dogra, MD & CEO
CARE Ratings

The growth in the financial sector across global markets has brought with it the introduction and deepening of sophisticated products which offer both investors and issuers a variety of benefits. This has led to the proliferation of exotic products in the derivative space at the extreme which are based on sound mathematical models that looked appealing. This has helped considerably in providing greater depth to the market as it brought with it a plethora of instruments as well as liquidity. Also given that overall growth in the last two decades has been robust across countries which were moving rapidly towards the free market mechanism based on economic liberalization, the demands on the financial systems have also increased.

This phase has also been associated with the growth of the capital market which provided an avenue for the two sets of players to meet, often anonymously through the trading screens. This has added to the level of transparency as well as robustness of the system. At times, simple products like fixed deposits offered very good returns and looked appealing, while the growth in the equity market led to the mushrooming of IPOs which evinced overenthusiastic response from the public. Further, in the west, the boom in mortgages led to the multiplicity of derivative products that helped to transfer risk across diversified investors. The question to be posed is as to how does an investor take a decision?

While institutional investors have their own techniques and models that have been developed by their employed professionals, similar tools are not available to the non-institutional investor. Often the decision is taken based on an announced or perceived return on an instrument with guidance being provided by probably an intermediary who could be a broker or his agent. Further, while financial firms do have the wherewithal to do their own research, others may not have

access to the same. In fact, they also have the advantage when dealing with such borrowers as there would also probably be an existing financial relationship with them. Intuitively one can see that there is the presence of information asymmetry in the market where the investor does not always know the background of the company or the instrument in which he may be interested. The most important factor for an investor is whether or not the instrument will be serviced as per the terms agreed upon and the principal returned on maturity. While annual reports provide a lot of information on past performance, interpreting the same or forming a perspective of the future performance of the instrument is still guess work. In fact, there are few individual investors who would have any idea about where to start from as finance is a specialized subject that requires specialized expertise. Besides they do not have access to the company or its management to understand the numbers or prospects. Also as the economic and business environment keeps changing over time, this affects the prospects for the industry as well as firm which have to be tracked. An individual investor would find it challenging to track the same.

This is where a credit rating opinion matters. Rating agencies are meant to assess default risk and talk about impairment of asset quality - the risk to cash flows on any credit. It is an informed indication of the likelihood of default of an issuer on a debt instrument, relative to the respective likelihoods of default of other issuers in the market. This has been the single important source of such information that is made available equally to all investors, thus making the system transparent and universal.

The concept of a credit rating agency (CRA) actually came up with this in mind as the process of disintermediation caught on. In a traditional transaction of intermediation, the public gives money to the bank in the form of a deposit which is largely guaranteed by the system -usually a deposit insurance scheme. In fact, if the bank is owned by the government, as several large ones are in India, it is assumed that banks would always have the tacit support of the government and any money kept with the bank is safe. The bank lends the same and takes on the credit risk, which it is able to evaluate given its own expertise in this business. They have to do so because when they are lending money to an entity, they have to evaluate the likelihood of default and accordingly fix the price which is the interest rate. Further, with the prudential practices being put into place by the RBI, it is even

more important for the bank to do a thorough appraisal. But an individual investor when investing in a bond or debenture, where there is direct interaction with the company, which saves in cost of intermediation, the risk has to be borne by the investor.

A credit rating agency gives a rating to the instrument, which is an opinion on whether the company can honour its commitments to the investor based on its current status, past history and future prospects. The analytical framework involves a thorough risk analysis relating to: business, technology, operations, economy, industry, market, financial and management. Hence there is a detailed understanding needed of the industry and market at the macro level and factors such as firm's operations, market position, financial and accounting quality, cash flows and financial flexibility. Even more subjective judgments of the competence and risk appetite of the management are made in the process. The analysis is hence two fold, where besides looking at the accounts and discussing them along with future prospects with the company, extensive meetings are held with the management to

understand the operations of the company as well as the use of funds.

CRAs do hence play a useful role in helping investors and others sift through this information, and analyze the credit risks they face when lending to a particular borrower or when purchasing an issuer's debt and debt like securities. CRAs also provide investors with rating reports, giving detailed information and analytical judgments on the issuer's business and financial risk profile. This assists investors in taking more informed investment decisions, calibrated to their own risk-return preferences. And since every rating is followed with an intensive surveillance where the company is monitored until such time that the instrument matures, the investor actually gets to know about the progress of the same. This is the major value addition because seldom does one track the performance of the company in which one buys, says a bond. The surveillance process, by its very nature ensures that this is done and that this information is made available publicly through various channels. As the CRA is a third party which has no inherent interest in the company, the opinion given is unbiased and independent.

Issuers with lower credit ratings pay higher interest rates embodying larger risk premiums than higher rated issuers. Credit rating agencies, in their role as information gatherers and processors, can reduce a firm's capital cost by certifying its value

in a market. Hence, there is also a major benefit for the company seeking to access the market. A credit rating compresses a large variety of information that needs to be known about the creditworthiness of the issuer of bonds and certain other financial instruments. The CRAs thus contribute to solving the classic principal agent problem by helping lenders pierce the fog of asymmetric information that surrounds lending relationships.

The same concept can be used for short-term instruments too where credit ratings can be used to denote in simple terms the creditworthiness of the borrower. The single letters in the alphabet that are displayed as the rating indicate the strength of the company or instrument. While the markets become more sophisticated with the introduction of structured products such as securitization, the same has been adapted to provide a credit opinion. Securitized instruments for example are backed by retail assets and are complex and require a more independent assessment of the risks involved. Unlike plain vanilla instruments such as bonds, where an investor can still independently assess a borrower's creditworthiness, in a securitization transaction there normally is little or no information in the public domain for an investor to carry out such an assessment. Understanding the nuances of different pools and analysis of the past behavior of asset classes are areas where CRAs can play an important role. This is major advantage of having CRAs who have the requisite expertise to evaluate such complex products too, though admittedly this pool of professionals is small but growing. Tracking the performance of the transaction and the corresponding impact on the riskiness of the instruments is a feature where CRAs play an important monitoring role.

These opinions, however, are not in the nature of advisory services for investors but only an additional input being provided on the instrument under consideration. Investors should note this because often a rating is mistaken as a recommendation which is not the intention; as such a decision has to be taken unilaterally by the investor. Therefore, it should be reiterated that a triple A rating is not an advice given by then CRA for purchasing the instrument but merely a statement that if one invests in an instrument with this rating you are certain to be serviced on time. Hence, investors should distinguish between the two.

Over time however, there has been substantial diversification in the concept of providing unbiased opinions from the debt segment to the equity market. In the IPO segment for instance, while the well established companies are known to all investors, the same may not be so for a lesser known or new company. This led to the creation of a grading product where the IPOs are graded on a scale of 1-5 so that investors have an idea of the strength of the company. The main purpose of IPO Grading, which SEBI had kept in mind while introducing this product, was to guide retail

investors and act as an alert to prevent them from investing in fundamentally weak, fly by night operators. It is believed that while there are several disclosures that are put forward to the prospective investors, they may not be in a position to interpret the same and hence could use this information to judge the fundamentals of the company. This really works well for small and midcap issuers as it gives them an opportunity to highlight their fundamental strengths as reflected in the grading assigned to them by an independent grading agency. As an extension, CARE ratings, for example has also developed the product, equigrade which grades equity scrips and this again is very useful for the small and mid-cap companies on which there is little equity research available to guide investors. These products have caught on from the point of view of both companies as well as investors. However, again caution has to be exercised in interpreting the grading given to IPOs as they are not in the nature of investment advice.

The canvas for grading is actually quite vast because it can used for various other products too such as education, energy use, maritime institutions, mutual funds and so on. The aim as always is to bridge the information gap between the two constituents.

Going ahead, there are essentially three challenges for rating agencies in developing a healthy investor appetite for both debt and equity. The first is to reach out to the companies in the mid-segment who are presently facing a problem in accessing the market for funds and paying a higher price. These companies are important from the point of view of industrial growth for the economy and have considerable capital expansion plans in the coming years. They have to be supported by access to affordable credit. Here, the CRAs can make a difference. The investors too could get involved in partaking this pie, which has been hitherto largely unexplored as the focus has been on the better rated companies in the large scale segment. The approach too has to be recast to suit the requirements as the kind of detailed information found in say the annual report of a large company may not be available for the smaller ones in the SME segment.

The second is to develop the debt market. Today borrowers prefer the safer confines of institutional lending due to a limited secondary debt market. This has in a way limited the growth of the market. Ratings if used pervasively can be the incentive for firms raising money as they can get funds at more competitive rates and revive the markets. Investors too get better returns here. Therefore, this input can be used to provide a fillip to the market to bring home also the advantages of disintermediation.

The last challenge is to help in the development of an orderly market

for structured products as the two should together for its success. This widens the basket of offerings for investors and deepens the market too. While this process is still in the initial phases there is scope for further acceleration in the next few years. One should remember that absence of requisite expertise in this area was one reason for the spread of the financial crisis where the agencies did not quite get the securitization ratings correct. In India, however, the picture has been different as the approach has been relatively more conservative. Quite clearly, the CRAs need to build and hone their skills in the evaluation of such products and the experiences with these similar products in the west would help in serving as useful signposts for the same.

Hence credit rating has become an integral part of investor awareness as it independently provides a vital input that goes into decision making. Based on statutory requirements as well as advantage to be had from having a rating, companies have progressively resorted to having their financial instruments rated. This in turn also has provided a self-check for companies which work towards improving their own performance in return of more favourable terms from lenders as higher rating mean lower interest rates as credit risk is accounted for. Investors too have been looking closely at these ratings before taking decisions. This exercise of awareness of ratings evidently has to be a continuous process as the investor community expands with the spread of financial literacy both in terms of geographic spread as well as changing risk profile.

D R Dogra
MD & CEO
CARE Ratings

Mr. D R Dogra has over 33 years of rich experience in credit rating, commercial banking and extensive knowledge about functioning of the corporate sector. Being one of CARE's first employees and an integral part of the top management since 1993, he has overseen the strategic growth and development of the company over the years. His passion and dedication is greatly responsible for the successful growth and development of CARE from a small spin off to a leading credit rating agency in the country.

Mr. Dogra holds a post-graduate degree in Management from FMS, University of Delhi. He is a gold medalist in his Post-Graduate Degree in Agriculture from Himachal Pradesh University. He is also a Certified Associate of the Indian Institute of Bankers. Prior to joining CARE, Mr. Dogra held several positions in Dena Bank for over 15 years.

INVESTOR AWARENESS AND PROTECTION-ENABLING FINANCIAL INCLUSION

Madhivanan Balakrishnan, Executive Director
ICICI Prudential Life Insurance Ltd.

The financial services sector in India has traversed a substantial distance over the last few decades. It has adopted and integrated global best practices of this industry as well as learning to ensure a carefully crafted regulatory structure to foster stable growth in the future.

Indeed, investor protection has been a key mandate for regulators that govern different asset classes across the banking and financial services sector. The regulatory system across asset classes is uniform in the various layers of protection it has created to ensure safety of investors. The efforts, initiatives and systems that have been introduced to ensure investor protection have been lauded not only by industry participants, but also by the regulatory systems across different countries.

However, despite the investor protection mechanism that is in force, the financial services sector including the capital markets remain under-penetrated. The low level of investor participation in the financial markets is due to lack of general awareness as well as a latent fear of insecurity. The low levels of penetration of non-banking products in financial savings speak not of investor apathy but of absence of adequate infrastructure to reach out to a larger pool of household savings. The pressing need of the hour is to encourage mass participation in the financial services sector and ensure that the benefits of different financial solutions percolate down to the masses. Simultaneously, it is extremely important to sensitize the new entrants about their rights and privileges as well as the associated risks. We need to channelize and harvest the potential of domestic savings into productive asset classes to ensure the stable growth and development of the sector.

The situation, as it stands, needs two fundamental issues to be addressed. The first being the need to address the low levels of awareness about financial products and investment options available to the target audience. This ideally should be followed by initiatives to build a strong foundation of trust by customers in companies that offer financial products and services.

A concerted effort by the industry in raising awareness regarding the need and importance of various financial products and services will aid in achieving scale and gainfully mobilize substantial quantum of savings. A country with over a billion citizens and the 10th largest economy in the world, one can only hazard a guess about the effect this can have on the economic growth of the country. Unless this is done in a sustained manner, it will not have the desired effect of attracting a larger segment of customers, who have so far been untouched by the benefits of financial products. Regulations and statutory codes cannot in isolation address this issue of creating mass awareness.

While building awareness is the first step, it is equally essential to

instill a degree of confidence in the investors / potential investors of the regulatory measures governing the industry. Knowing that recourse is available will provide comfort to investors and ensure the development of a robust financial services industry. Sporadic instances of scams over the past have dented investor confidence and hence gaining and fortifying the trust of investors while being a challenge should be an ongoing endeavor. As industry stakeholders, we need to re-tool ourselves and understand the apprehensions of investors, whether legitimate or irrational, regarding the level of safety offered by the financial sector.

The architecture of investor protection in the Indian financial services sector is robust, sound and well designed, keeping in mind the interests of all stakeholders and participants. However, the industry has to in a compelling manner address the apprehensions of the masses, if any, regarding the sanctity of the regulatory structure governing the sector. The industry has taken phenomenal strides in the adoption of technology across all asset classes and thereby provided a higher degree of convenience and safety to investors. Today, customers can transact shares and stocks on their mobile phones, buy insurance policies on the web or do a full suite of transactions on an online banking platform. These and other similar innovations have revolutionized the financial services sector and have gone a long way in providing a sense of

reassurance to investors over the years. As an industry, we need to be cognizant of the fact that we need to be more aligned with the needs of our customers, understand them and move forward with them towards sustainable and stable growth. As an industry, we have been able to move closer to our customer and the increasing use of technology has enabled the customer to embrace and experience the brand. The objective is to go beyond a transactional engagement with our customers and have a deeper and more meaningful engagement whereby they see the financial services industry as a partner in helping them achieve their life's financial goals. This will only be possible when they trust us and are convinced about the various checks and balances that are in place regarding investor protection.

Demystifying financial services and products and engaging with customers in a manner and mode which will enable them to understand the value proposition will greatly benefit the industry. While we, as an industry have made in-roads in this area, we still have some way to go. Only by ensuring that the customer understands the different products that we have to offer can he choose the product that best serves his needs. A case in point here is of the feature of a 'free-look period' offered by the insurance industry. It is an example of how customers can be empowered to return a product if he or she realizes that it does not best serve his financial needs and goals.

This brings me to the related point of how we approach the customer. Our distribution partners need to be empowered and educated to such a level that they take on the role of being a trusted advisors to customers. This in my opinion will completely eradicate any misgivings that investors may have about the distributors of financial services products. It is imperative that our distributors represent the industry in the right vein and radiate trust and empathy towards the customer. Additionally, customers need to take note of and realize the value addition that distributors provide to their decision making process. We need to ensure that our distributors are seen as 'advisors'. For this to happen, we, as an industry need to focus on providing higher levels of education to our distributors who represent us as the face of the company to our prospective customers. Also, a customer-centric focus requires us to invest in building durable long term relationships with our customers.

The two pillars of a successful and sustainable, financial services franchise will have to be investor awareness and protection. Customer education cannot be stressed enough in our country where the level of financial literacy is very low. As an industry we have the twin tasks of first channelizing household savings to financial savings, and within that genre to move to products and services which are aligned to their financial goals in life. Financial inclusion needs to be increasingly advocated and practiced to ensure that the benefits offered by the financial services sector permeates down to the smaller regions and across different income segments. A well articulated investor protection architecture will go a long way in assuaging any inherent fears that these prospective customer segments may have as they take their first steps into the financial services sector. We also need to set up circles of influence around the target groups so that messages pertaining to investor protection can be reinforced.

The different Regulators governing various facets of the financial services sector have done a commendable job in providing a platform to facilitate growth. Now, it is up to us, the industry participants to communicate a unified message to our current and prospective customers and harness the enormous untapped potential of household savings. The Indian financial services sector has traversed a long journey since the economy was liberalized. Let us jointly take the responsibility of taking this industry into the next orbit through collective and inclusive growth.

Madhivanan Balakrishnan
Executive Director
ICICI Prudential Life Insurance Ltd.,

Madhivanan Balakrishnan is Executive Director at ICICI Prudential Life Insurance and is in charge of Customer Service, Technology, Marketing and Infrastructure. He has overall responsibility for the entire backbone of the business, including underwriting, claims, operations, technology, customer service including the call centre and the Six Sigma quality initiative.

Prior to joining ICICI Prudential Life, Mr. Madhivanan Balakrishnan was the Senior General Manager, ICICI Bank and Head Customer Service & Retail Risk division. He was also in charge of the Internet Banking division for the bank.

He joined ICICI Bank in 1999, with a strong background in sales and marketing and business development across consumer business companies such as Pepsi Foods Ltd. and Goodlass Nerolac paints Ltd. Mr. Madhivanan was a part of the team that launched the ICICI Bank card product and later he was made responsible for all aspects of the card business. Under his leadership ICICI Bank emerged as one of the leading players in the Indian credit card market and the personal loans business.

Mr. Madhivanan has completed his formal education in Management from Indian Institute of Management - Calcutta, in 1992. Mr. Madhivanan is a member in various advisory forums for the payment industry and IBA forums. Earlier, he was also associated with the RBI Committee on micro- payments, Customer Service committee.

INVESTOR AWARENESS & PROTECTION

V. Ravi, *Chief Financial Officer*
Mahindra & Mahindra Financial Services Limited (MMFSL)

The core principles of securities regulations are as under :

(a) Protection of investors.

(b) Ensuring transparent, efficient and fair market.

(c) Reduction of systemic risks.

These three objectives are inter-related. Measures taken to reduce systemic risks often lead to investor protection. A fair and efficient market will also have less of systemic risks. Monitoring of compliance and enforcement of appropriate regulations reside with Securities and Exchange Board of India (SEBI). Similarly, the responsibility lies with US Securities And Exchange Commission (SEC), Securities And Exchange Commission in UK. Investors should have access to appropriate information which are material before making an investment decision. Such information should clearly state the possible risks and rewards that may arise out of the investment. In order to achieve effective disclosure, it is necessary to put in place an internationally acceptable accounts and auditing standards.

It is necessary that, only competent entities / persons are authorized to provide investment services or act as market intermediaries or stock brokers. These market intermediaries should be properly capitalised and are equipped with professional competence. The level of capitalization should be adequate to meet the initial and ongoing requirement and counter party risks.

Investors need to be protected from insider trading, front running, misappropriation of client's assets and any other fraud or manipulative practices.

There should be minimum standards for market participants. Regulator should ensure that the intermediaries treat the investors in an equitable manner. It is extremely important, as individual investors are vulnerable for sub standard treatment and often they do not have the wherewithal to take any action.

Investors should also have access to independent resolution mechanism like courts and/or tribunals etc. The fairness of the market is linked to investor protection and prevention of

improper trading practices. The framework should not favour certain market players over others. Regulations should be capable of preventing any market manipulation and enable detection at the earliest, if a breach were to happen. Measures to be put in place for quick disposal of such breaches and punishment of guilty.

Regulation should aim to provide access to market facilities and price information. It should pave the way for a proper pre and post processing, so as to have a reliable price formation. In short, regulation should promote market efficiency and wide spread dissemination of relevant information.

Information of both pre-trade and post trade must be made available to public on a real time basis. Pre-trade information consists of posting of firm bids and offers with indicative prices. Post trade information is about price and the volume of individual transaction actually carried out.

Even though it is not possible to prevent fully, the failure of market intermediaries, regulations should ensure that the risk of failure does not spread and it is contained at the earliest. Regulations should also address inter-connectedness and restrict the risk, to the failing institution. Accordingly, market intermediaries should be adequately capitalized and augment their capital in line with their operations.

Risk taking is a part of an efficient market and regulations should check excessive risk taking. Regulation should provide for effective management of risk, provision of adequate capital and systems and processes for monitoring of risks on a continuous basis. A framework to be put in place for a proper default time line as well as a system to deal with loss of capital or insolvency.

In case of public offering and trading of securities a proper and full disclosure of accurate information is required. It is therefore necessary that the content of advertisement, issue memorandum, periodic report, reports of material events, change in control are made public with adequate disclosure as quick as possible.

In India, regulatory framework has specified disclosure requirements for public offering of securities like equity shares or debt instrument by companies. There are also conditions applicable for offering of securities for public sale (offer for sale), the content and distribution of prospectus and related offer documents. The requirements have to be in compliance with SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 and also with the relevant provisions of the Companies Act, 1956.

The provisions of Companies Act provide disclosure requirements that are applicable to the annual reports and time frame within which these annual reports have to be sent to the shareholders. Listed companies are required to disclose certain information as per the listing agreements executed with the Stock Exchanges on which their shares are listed. Clause 49 of the Listing Agreement requires the Management Discussion and Analysis Report and a Report on Corporate Governance to be included in the Annual Report. In addition to annual reports there are periodic reports to be furnished to the Exchanges on a quarterly basis and dissemination of information is required under certain circumstances.

Under the provisions of the Companies Act notice of the general meeting to include explanatory statement of all material information in respect of special business. The provisions in the following requires for timely disclosure of events that are material to the price or value of listed securities:

(a) SEBI (Prohibition of Insider Trading) Regulations 1992.

(b) SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

(c) Listing Agreement with Stock Exchange.

In case of investors wanting to participate in the derivative market there is a requirement for the intermediary to provide risk disclosure documents to each and every client duly signed and exchanged by them. This ensures that the participants are aware of the risk in hand in dealing with derivatives. Further by prescribing a higher minimum lot only sophisticated investors and high net worth individuals are generally expected to deal in this market.

Already there are adequate regulations in place to protect the individual investor's/ shareholder's interest. Some of the provisions are mentioned below:

(a) Listed companies to have a minimum of 50% Directors on the Board as independent Directors. There are certain requirements to be fulfilled for a Director to be considered as an independent Director.

(b) In case of take over open offer of 25% is required to be made for facilitating exit of small shareholders.

(c) SEBI has recently mandated that small shareholders should also be paid same price as paid to the promoter including non-compete fee. In case of de-listing of shares the regulations balance the interest of minority shareholders with that of promoters.

(d) Till now portfolio management schemes were really leniently governed. Of late after certain incidents, SEBI has tightened safeguards related to power of attorney that is executed in favour of brokers and for opening demat accounts. The SEBI website has enough information for awareness of investor and it has made

several publications to enhance the awareness of the common investor.

(e) SEBI has recently directed that the details of the transactions done in equity-cash and derivative-segments of the Stock Exchanges on each trading day shall be sent by the Stock Exchanges to the investors, by the end of each trading day, through SMS and E-mail alerts.

(f) SEBI has also recently amended the regulations for certain intermediaries viz. Stock Brokers and Sub-brokers, Merchant Bankers, Debenture Trustees, Registrar to an Issue and Share Transfer Agents, Underwriters, Depository Participants, Bankers to an Issue and Credit Rating Agencies in order to reduce the Investor grievances and procedural hassles for the capital market Intermediaries.

Steps taken for investor awareness

Many investors even in major cities may not possess adequate knowledge to take informed investment decisions. It is also possible that they are not aware of the complete risk return profile of the different investment options. It is also necessary to make the investors fully aware of the precautions they should take while dealing with market intermediaries.

It is also equally important that they are familiar with the various right that they have as a shareholder. Some of the important rights like :

- To receive share certificate on allotment in case of physical and in demat if it is electronic.
- To receive copies of Annual Report.
- To inspect the minutes books of the general meetings.
- To apply for winding up of the Company.
- To receive offer under take over or buy back.
- To requisite an EGM.
- To demand a poll on any resolution.
- To apply to CLB to investigate the affairs of the Company.

Investors are to be made aware of the benefit of dealing through a stock exchange in order to avoid counter party risks. Also dealing through a stock exchange provides access to the price information so that the deals can be executed at their best price possible. While dealing through a broker, investor should note that they have a right to demand appropriate contract note within a specified time.

SEBI has launched various investor education programmes as below :

- "Securities Market Awareness Campaign (SMAC)" - A comprehensive education campaign aimed at creating awareness among investors about securities market. The motto of this campaign is "An educated investor is a protected investor".
- SMAC conducts workshops all across the country which is actively participated by market participants, market intermediaries, Investor Associations. The message of the campaign is "Invest With Knowledge".
- Through advertisement in newspapers, SEBI has informed investors about simple "dos and don'ts" for investors relating to various aspects of the securities market".
- Educative Materials - SEBI has prepared a standardized reading material and presentation material for the workshops.
- All India Radio - With regard to educating investors through the medium of radio, SEBI Officials regularly participate in programmes aired by All India Radio.
- Website dedicated to Investor Education http://investor.sebi.gov.in.
- Cautionary Message aired on television.
- Internet based response system - A simple and effective internet based response to investor complaints has been set up.

There are several forums for the investors to make complaints and for reddressal of grievances in respect of securities, company affairs, fixed deposits, forfeiture of shares, etc.:

- With the Stock Exchanges at their Investor Information Center.
- With the Department of Company Affairs / concerned Registrar of Companies (ROC).
- With the Reserve Bank of India.
- With the concerned company / ROC.

In addition to the above forums, investors can also directly approach SEBI for various types of grievance as mentioned below:

- Refund Order/ Allotment Advise
- Non-receipt of dividend.
- Non-receipt of share certificates after transfer.
- Debentures.
- Non-receipt of letter of offer for rights.
- Collective Investment Schemes.
- Mutual Funds/ Venture Capital Funds/ Foreign Venture Capital Investors/
- Foreign Institutional Investors/ Portfolio Managers, Custodians.
- Brokers/ Securities Lending Intermediaries/ Merchant Bankers/ Registrars and Transfer Agents/ Debenture Trustees/ Bankers to Issue/ Underwriters/ Credit Rating Agencies/Depository Participants.

- Securities Exchanges/ Clearing and Settlement Organizations/ Depositories.
- Derivative Trading.
- Corporate Governance/ Corporate Restructuring/Substantial Acquisition and Takeovers/ Buyback / Delisting / Compliance With Listing Conditions.

Investors are the back bone of the Securities Market. And we have come a long way in our journey to create investor awareness and ensure protection of their rights. This is imperative for the orderly growth of Securities Market

V. Ravi
Chief Financial Officer
Mahindra & Mahindra Financial Services Limited (MMFSL),

Mr. V. Ravi is the Chief Financial Officer (CFO) of Mahindra & Mahindra Financial Services Limited (MMFSL), the Company which is in the business of financial services for the last 19 years. Mr. Ravi has been associated with MMFSL from its inception.

MMFSL has above Rs. 15,000 Crores Assets under Management with 560 branches spread across the country. MMFSL is managed by a team of young managers with employee strength upward of 10,000 people. The Company has maintained an aggressive growth year on year since its inception. MMFSL has three subsidiaries viz. (1) Mahindra Rural Housing Finance Company Limited is engaged in extending finance to customers in semi urban / rural India for House construction/ extension / renovation (2) Mahindra Insurance Brokers Limited is in the business of insurance broking, advising customers on both life and non-life insurance, and distributing policies of national and private insurers (3) Mahindra Business and Consulting Services Private Limited is engaged in providing human resources pertaining to services like back office and support services

Mr. Ravi is also on the Board of following Group Companies;

- Mahindra Insurance Brokers Limited (MIBL), an insurance broking firm engaged in both life as well non-life business and a subsidiary of MMFSL.
- Mahindra Rural Housing Finance Company Ltd., which is set up to provide mortgage loans.
- Mahindra Business and Consulting Services Private Limited.

Mr. Ravi is a member of the FICCI Committee on Corporate Finance since 2011. He has also been a member of the Asia Council of the Conference Board, USA and the Informal Advisory Group of the Reserve Bank of India.

Education :

Ravi is Chartered and Cost Accountant. He has done Long duration Global Managers Program from IIM, Calcutta.

Mr. Ravi also attended the Breakthrough Programme for Senior Executives from International Institute for Management Development (IMD), Switzerland. Mr. Ravi has also undergone Mahindra Universe Program at Harvard Business School, USA.

Ravi is with Mahindra Group for the past 21 years. He has served with Mahindra Ugine Steel Company (MUSCO) for 9 years in Treasury, Finance and Diversification Projects prior to his induction in Mahindra & Mahindra Financial Services Limited way back in 1994.

INDIAN ECONOMY – AN UPDATE

Box1. Key Facts

- GDP growth in FY 2011-12 has been projected to be 8.2 per cent by the Prime Minister Economic Advisory Council while the RBI expects it to be around 8 per cent.
- Inflation continues to be the dominant concern which has impacted business confidence. With WPI based inflation standing high at 9.3 per cent in July, the persistent rise in price level has become more broad-based.
- The moderation in industrial growth has become more evident as average growth of the manufacturing sector for the first quarter of fiscal stood at 7.5 per cent as against 10.3 per cent for the corresponding period of last year.
- In its June update of the World Economic Outlook, the IMF marginally lowered its global growth projection for 2011 to 4.3 per cent from 4.4 per cent.
- Given the evolving situation, we expect GDP growth in 2011-12 to be marginally below 8 per cent mark.

Economic Scenario

Signs of slowdown in economic activity have begun to materialize. GDP growth showed signals of some moderation during Q1 FY 2011-12 with fear of significant growth deceleration in the current fiscal. Signs of moderation were visible from deceleration in IIP growth in April-June, poor performance of certain core industries and consumption deceleration in cement, steel and automobiles. RBI and PMEAC have forecasted a slowdown in economic growth. Both IMF and ADB have also projected a moderation in the growth prospects for the Indian economy on account of base effects and policy tightening.

The general expectation from the much awaited Monetary Policy review for the first quarter of FY 2011-12 was further hike in the policy rates in the range of 25 bps. However, going a huge step ahead RBI hiked the policy rate by 50 bps clearly indicating that in the trade-off between growth and inflation, the Central Bank has clearly decided to sacrifice growth.

Of late, the transmission of monetary tightening by RBI has been fairly strong. With banks passing on the burden, the industry is faced with an upsurge in cost of capital. The industrial activity in the interest sensitive sectors viz Auto, Real Estate has begun to feel the impact of hardening interest rates which is

likely to choke growth.

While FICCI appreciates RBI's concerns over the evolving inflation trajectory, the role of the government is more vital, therefore, we expect the latter to share a greater burden in inflation management. It's time for the Government to have a hard look on supply side constraints which if taken care of will lessen the current burden on RBI of managing this difficult scenario.

Commenting on the 11th increase in key policy rate in the current rate hike cycle, Dr. Rajiv Kumar, Secretary General, FICCI said "RBI's announcement of 50 basis points increase in repo rate comes as a major disappointment to the industry. With the growth momentum already under pressure, this move will further hurt the future prospects. Even the projected growth rate of 8 per cent for the year 2011-12 now looks difficult to achieve."

The apex bank has tightened monetary policy 11 times since March 2010 (repo rate increased from 4.75 per cent to 8 per cent by July 2011) to contain inflation. But the relentless hike in interest rates has resulted in sharp slowdown in industrial growth (industrial growth at 6.8 per cent during April-June 2011 vis-à-vis 9.6 per cent in the like period previous year), dip in investment intentions (no of new projects stalled to total no of new projects touched a high of 47 per cent during June 2011 vis-à-vis 39 per cent a year back) and a clear softening of bank credit growth (19.3 per cent as of mid-July in comparison with 21.3 per cent for the like period previous year).

Inflation

Inflation continues to be the dominant macroeconomic concern. Upward revision in prices of petroleum products, significant increase in the minimum support prices for some agricultural commodities and persistent high level of non-food manufactured product prices have prevented inflation from easing.

Evolving dynamics in the headline inflation suggests generalization of inflationary pressure, which has led to WPI inflation becoming broad-based across categories. The average inflation rate for non-food manufactured products (Core Inflation) in the first quarter of FY 2011-12 is above 7 per cent compared with an average rate of 4 per cent over the last six years.

The global commodity prices and domestic demand supply gap in several commodities have exerted upward pressures on inflation in the recent past. Despite the repeated increase in key policy rates (11 times since March 2010), inflation continues to be much above the comfort level of RBI.

Keeping in view the domestic demand-supply balance, the global trends in commodity prices and the likely demand scenario, the RBI has revised upward its baseline projection for WPI inflation for March 2012 from 6 per cent to 7 per cent. As admitted by RBI in its monetary policy stance, inflation in the future would depend largely on

a) Overall performance of the south-west monsoon
b) Outlook on crude oil price and how the impact of higher crude prices is passed through
c) Increase in price of administered items, like Coal, in the WPI basket
d) Global trends in commodity prices and the likely demand scenario

Performance of IIP

Industrial growth as measured by the Index of Industrial Production (IIP) with the new base year 2004-05 for the first quarter of the fiscal averaged 6.8 per cent, compared to 9.6 per cent in the same period last year. The IIP performance is even worse as per the old series of index, with a base year of 1993-94, which recorded industrial growth at 4.0 per cent during Q1FY 2011-12 as against 11.9 per cent in the corresponding period last year.

What concerns the most is the declining trend in manufacturing sector growth and a significant deceleration in the production of core infrastructure industries. Average growth in the manufacturing sector for Q1 FY 2011-12 slowed down to 7.5 per cent as per the new base year and a meager 3.9 per cent with old base as against corresponding figures of 10.3 per cent and 12.6 per cent respectively. The growth of core industries during Q1 FY 2011-12 also slowed down to 5.0 per cent from 6.8 per cent in the same quarter previous year.

The slowdown in industrial growth is all pervasive, with both investment demand (capital goods growth at a measly 3.1 per cent during April-June 2011 vis-à-vis 32.0 per cent in the like period previous year) and consumer demand (consumer durables goods growth at 5.2 per cent during April-June 2011 vis-à-vis 9.2 per cent in the like period previous year) being hit. This indicates weakening of both investment and private consumption which would impact the aggregate demand in the domestic economy.

Liquidity position & Financial Markets

Monetary conditions remained tight during Q1 of 2011-12 with interest rates firming, deposit growth picking up and credit growth decelerating.

Liquidity conditions eased significantly during Q1 of 2011-12. The average availment of liquidity under LAF was lower at around Rs. 49,300 crore in Q1 of 2011-12 as compared with around Rs. 84,400 crore in Q4 of 2010-11.

Since the beginning of the fiscal, financial markets have seen turbulent times which are reflected in firming up of interest rate in the debt markets and consistent month-on-month decline for the equity markets. The global economic scenario has played a role in upsetting the sentiments aggravated by concerns on domestic economic slowdown. With the growing concerns on the economic outlook and falling business confidence, the Sensex tested the below 16000 mark.

Table1: Key Indicators of Financial markets

	Apr'11	May'11	Jun'11	Average Q1 FY'12
Call Rate* (per cent)	6.58	7.15	7.38	7.04
Market Repo Rate (Non-LAF) (per cent)	5.55	7.05	7.30	6.63
G-Sec 10-year yield (per cent)	8.05	8.31	8.28	8.21
Exchange Rate (INR/US $)	44.37	44.90	44.85	44.71
CNX Nifty **	5839	5492	5473	5601
BSE Sensex **	19450	18325	18229	18668

Notes:*: Average of daily weighted call money rates
**: Average of daily closing indices
Source: Reserve Bank of India

The financial markets performance in the coming months would definitely be conditioned by macroeconomic uncertainties both in domestic and global platforms and positioning of capital inflow in the coming months.

Downgrade of US credit rating and the Federal Reserve's announcement to keep interest rates low for another two years is likely to support capital inflows into emerging market economies including India. With expectations firming up for another round of Quantitative Easing (QE3) in US, it looks could result in some money flowing towards the Indian shores.

It is interesting to note, the global commodities market has shown

some sign of moderation as the Reuters-Jefferies CRB commodities index touched significantly lower levels. The downward trend in Crude Oil prices augur well for a decline in inflation rate.

Balance of Payments

As per its Economic Outlook for FY 2011-12, the Prime Minister's Economic Advisory Council projects a current account deficit of 2.7 per cent of GDP. The capital account situation is likely to remain comfortable with net FDI and FII inflows at US $ 18 billion and US $ 14 billion respectively. Therefore, the financing of current account deficit is unlikely to put pressure on the Indian economy.

Exports growth in the first quarter of the fiscal has been robust and though imports have also shown strong growth rates, these have been lower than that of exports. However, there have been growing concerns on sustainability of robust export growth rates in the second half of fiscal.

During last fiscal (FY 2010-11), monthly exports averaged US $ 23 billion in the second half of fiscal versus US $ 17 billion in the first half. The trend is continuing in the current fiscal also. During April-June quarter of 2011-12, in value terms exports averaged US $ 26 billion despite a fragile global economic environment.

Table2: External Sector Performance

BoP (US $ Billion)	2010-11P	2010-11			
		Q1PR	Q2PR	Q3PR	Q4P
Exports	182.2	55.3	52.0	65.9	77.2
Imports	300.6	87.2	89.3	97.4	107.1
Trade Balance (1-2)	**-118.4**	**-31.9**	**-37.3**	**-31.5**	**-29.9**
Current Account Balance	**-38.4**	**-12.1**	**-16.8**	**-10.0**	**-5.4**
Net Capital Account	53.4	16.8	21.4	13.4	8.2
Overall Balance	**13.4**	**3.7**	**3.3**	**4.0**	**2.0**
Forex Reserves in **US $ Billion** (as on July 29, 2011)					**319.09**

PR: Partially Revised; P: Provisional
Source: Reserve Bank of India

The outlook for exports is also tempered on account of factors such as rising interest rates at home, rising raw material prices and rising cost of oil and oil products. The closure of the DEPB scheme by end September 2011 is another factor that would undermine export growth going ahead.

On the capital account side, FDI and FII flows have shown stark differences. FDI increased by a whopping 133 per cent to US $ 13.4 billion in Q1 FY 2011-12 from US $ 5.77 billion in the corresponding period last year. On the other hand, the FIIs have pulled out their investments from the Indian equity

markets with a net outflow of US $ 112.3 million till August 25, 2011.

Future Outlook

The key elements of near term economic outlook as brought out in FICCI's recent Economic Outlook Survey are given below:

- The surveyed economists expect the GDP growth to moderate to 7.9 per cent in FY 2011-12. On inflation, majority of the economists said though the inflationary pressures are expected to persist in the near term, it is likely to moderate to 6.6 per cent by the end of fiscal year.
- Survey findings revealed the current trend of high export growth is not likely to be sustained in the months ahead. The sovereign debt crisis in Euro zone, weakness in the US and moderation of economic activity in China may significantly affect the level of external demand.
- Going with the IMF view, surveyed analysts expect the current problems in the world economy to

be transitory. Further, the survey participants feel that at this stage it may not be right for RBI to get deviated by the global demand situation and let that impact its current monetary policy stance.

FICCI's Economic Outlook Survey Forecasts - July 2011

Key Macroeconomic Variables	Annual Forecast 2011-12			
	Mean	**Median**	**Max**	**Min**
1 GDP growth rate at factor cost (%)	8.0	7.9	8.9	7.5
Agriculture & Allied	3.9	3.8	7.0	2.5
Industry	7.5	7.3	9.0	6.1
Services	9.7	9.4	15.0	8.3
2 Fiscal Deficit (as % to GDP) Centre (end March 2012)	5.3	5.1	7.0	4.8
3 WPI Inflation rate (%, end March 2012)	6.6	6.6	7.5	5.0
4 Growth in IIP (%)	7.2	7.3	8.9	4.4
5 Merchandise Export growth (%)	21.9	20.4	41.0	11.8
6 Merchandise Import growth (%)	23.3	22.6	39.0	11.6
7 Trade Balance (% to GDP)	-7.5	-7.5	-6.3	-9.1
8 Current Account Balance (%)	-2.9	-2.7	-2.0	-5.0
9 US$ / INR exchange rate (end March 2012)	44.2	44.0	45.5	42.8

Banking Sector

RBI First Quarter Review of Monetary policy

The Reserve Bank of India (RBI) announced the following changes in the monetary policy in its first quarter review of FY 2011-12:

- Increase in the policy repo rate under the liquidity adjustment facility (LAF) by 50 basis points. The **repo rate** will accordingly move up from 7.5 per cent to **8.0 per cent**.
- Consequently, the **reverse repo rate** under the LAF, determined with a spread of 100 basis point below the repo rate, automatically adjusts to 7.0 per cent.
- Similarly, the **Marginal Standing Facility (MSF)** rate, determined with a spread of 100 bps above the repo rate, stands recalibrated at **9.0 per cent.**
- Headline **inflation target** for March 2012 is increased from 6 per cent to 7 per cent YoY.

However, the **GDP growth projection** was retained at 8 per cent for 2011-12.

Most of the market participants were expecting the RBI to hike both Repo Rate and Reverse Repo Rate by 25 basis points.

RBI extends time limit for FCCB buyback

The Reserve Bank of India on June 30 extended the time limit for buyback of foreign currency convertible bonds (FCCB) issued by Indian companies up to March 31, 2012, at discounted rates.

The discount rates have been decreased from 15 to eight per cent for premature buyback under the automatic route and from 25 per cent to 20 per cent under the approval route.

RBI lays out strict and tedious rules for banks lending to real estate sector

The Reserve Bank of India has laid out strict and tedious due diligence standards for banks in sanctioning loans to the real estate sector after inspections found that most frauds were due to document forgeries even after certified by lawyers and chartered accountants.

RBI allows refinance for FCCB redemptions

Amid difficulties faced by Indian companies to repay loans taken under Foreign Currency Convertible Bonds (FCCBs), the RBI on July 5 allowed refinancing for its redemption by allowing firms to raise fresh overseas borrowing under the automatic route. As per the notification:

- Indian companies are permitted to raise fresh External Commercial Borrowings (ECB)/FCCB as per the extant ECB guidelines under the automatic route to refinance their outstanding FCCBs.
- The amount of fresh ECB/FCCB should not exceed the outstanding redemption value at maturity of the outstanding FCCBs.
- The fresh ECB/FCCB shall not be raised six months prior to the maturity date of the outstanding FCCBs.

RBI caps banks' equity investment in companies

The Reserve Bank of India (RBI) on July 6 capped banks' equity investment ceiling in companies and subsidiaries to prevent lenders from having any significant influence. Banks cannot invest more than 10% of their paid-up capital in a subsidiary or financial services company, while total investments made in all subsidiaries and non-

subsidiary financial services companies should not exceed 20%, the RBI said in a draft guideline on equity investments by scheduled commercial banks in subsidiaries and other companies.

RBI caps bank investments in debt schemes of mutual funds

The Reserve Bank of India on July 5 capped bank's investments into liquid schemes of mutual funds to 10% of the bank's net worth as on March 31 of the previous fiscal year in order to prevent circular flow of funds between banks and mutual funds that could lead to systemic risk in times of liquidity crunch.

Bank investment in such debt schemes of mutual funds with weighted average maturity of portfolio of not more than one year, would be subjected to the cap.

RBI asks foreign firms to regularise branch offices

The Reserve Bank on July 15 directed all the foreign entities, including non-government organisations (NGOs) and news agencies, operating in the country through branch offices to obtain clearance from it within three months under the Fema Act.

"The foreign entities who have established Branch Offices or Liaison Office in India and continuing to function without obtaining permission from the Reserve Bank of India should approach the Reserve Bank within a period of 90 days from the date of issue of this circular for regularisation of establishment of such offices in India, in terms of the extant FEMA provisions," the central bank said in a statement.

RBI asks lenders to open 25% branches in rural areas

Taking its financial inclusion plan in rural areas forward, the Reserve Bank of India has asked banks to open one branch for every four of their new branches in unbanked areas.

In a notification issued to all scheduled commercial banks, the RBI has said that while preparing annual branch expansion plan, 25 per cent of the new branches should be opened in Tier-5 and Tier-6 centres. It has also said for each branch proposed to be opened in unbanked areas, permission will be given for another branch in metros and major towns.

Foreigners can hedge currency exposure in rupee: RBI

In a move that will facilitate greater trade transactions in the rupee, the Reserve Bank of India has allowed non-resident importers and exporters to hedge their currency exposure in the rupee through forward foreign exchange contracts.

RBI panel wants banks to serve customers better

A high-profile committee on customer services by banks has suggested sweeping changes in banking practices relating to penalty for non-maintenance of the minimum balance, shifting home loans, recovering money after failed ATM transactions, etc. The report of the committee headed by former Securities and Exchange Board of India (SEBI) chairman M Damodaran has been submitted to the Reserve Bank of India (RBI).

On the deposits side, the panel said all banks should offer plain vanilla savings accounts with certain privileges like cheque facility, ATM card, etc without prescribing a minimum balance. It has also been suggested that banks not auto-renew deposit accounts without written customer consent. Insurance cover for deposits has been suggested to be raised to Rs 500,000 from Rs 100,000 now.

Banks can issue prepaid instruments only to listed companies: RBI

The Reserve Bank of India (RBI) on August 4 said prepaid payment instruments such as smart cards, magnetic stripe cards, mobile wallets could be issued by banks only to corporates listed in India.

In a circular issued to all banks, the RBI said, "Prepaid payment instruments can be issues only to corporate entities listed in any of the stock exchanges in India." It further said the corporates would have to verify the identity of the employee to whom the card would be issued, along with copies of photograph and a proof of identity.

RBI reconstitutes Technical Advisory Committee

The Reserve Bank of India on August 4 reconstituted the Technical Advisory Committee (TAC) which gives necessary suggestions to the central bank on stance of monetary policy in the light of macroeconomic and monetary developments. The tenure of the reconstituted committee would be up to June 30, 2013.

RBI panel bats for customer-friendly forex dealings

Seeking improvement in individual foreign exchange transactions, a Reserve Bank of India (RBI) panel has said the central bank should allow non-resident Indians (NRIs) to jointly open joint foreign currency non-resident (FCNR)/non-resident external (NRE) accounts with a resident relative.

RBI can permit the opening of FCNR accounts in any freely convertible currency, said the panel, headed by K J Udeshi, former deputy RBI governor, constituted in May. Its report was given to RBI on August 8.

RBI may soon let banks assess credit risk internally

The RBI is planning to allow banks to calculate at their own the capital requirement to handle credit risk if they meet certain criteria, like risk oversight norms and corporate governance. RBI has issued draft guidelines for allowing banks to shift to Internal Rating Based (IRB) Approach. Under this scheme banks are allowed to use their own internal estimates for some or all of the credit risk components in determining the capital requirement for a given credit exposure.

RBI nudges banks to lend more to weaker sections

Credit flow to fund-starved microfinance and agriculture sectors, small companies and those operating in economically weaker sections may get a boost with the Reserve Bank of India (RBI) pushing lenders to loan more money to them.

In July, the banking regulator made it mandatory for banks to report their so-called priority sector lending details to it in every quarter instead half-yearly. Ahead of that, in May, RBI had taken away the priority sector status to bank loans given to non-banking finance companies (NBFCs),

excluding those incorporated as microfinance institutions, or MFIs, to ensure proper end-use of such funds.

RBI issues operational guidelines for financial inclusion

The Reserve Bank of India (RBI) on August 12 issued operational guidelines for the implementation of a transfer system for servicing low-value accounts and extending banking infrastructure to under-served low income areas.

The regulator asked banks to follow the 'one district-many banks-one leader bank' model in villages in which the designated bank under the financial inclusion plan and the fund-transfer system varied.

Draft Microfinance Bill gives RBI total control and puts sector under strict watch

The government has proposed a regulatory framework for the microfinance industry that provides protection to the consumer makes the Reserve Bank of India the sole regulator and puts industry under a strict watch. The draft Micro Finance Bill 2011 gives sweeping power to the RBI by bringing all aspect of microfinance under its oversight.

Capital Market

SEBI lists norms for online, mobile trade

Capital market regulator SEBI has directed stock exchanges to ensure that additional security measures are taken by brokers offering internet based trading (IBT) and securities trading using wireless technology (STWT).

The Securities and Exchange Board of India (SEBI) on June 30 listed out measures that brokers offering internet and mobile trading should adopt to improve their systems and processes.

SEBI tweaks intermediaries' registration process

Capital market regulator SEBI has notified Credit Rating Agencies, Debenture Trustees, Bankers to an issue, Depositories and Participants, Merchant Bankers, RTAs and Underwriters that the registration of these entities will now be for an initial period of five years or permanent, as the case may be.

For these entities the words "registration granted or renewed" will be replaced by the words "initial or permanent registration granted," SEBI said in a circular issued on Thursday.

LLPs can get membership of stock exchanges: SEBI

Capital Market regulator SEBI on July 11 said Limited Liability Partnership (LLPs), a hybrid between a partnership firm and company, can get membership of stock exchanges. Following Requests from various stock exchanges to permit LLPs to be admitted as members to enable them to get registration as stock brokers, SEBI said: "Stock exchanges may consider granting membership to LLPs"

SEBI seeks more disclosures on P-notes to track black money

To track possible illegal money coming into India, the capital market regulator wants foreign institutional investors (FIIs) to name upfront the beneficiaries of participatory notes, or P-notes, and other offshore derivative instruments (ODIs).

SEBI to regulate all companies issuing shares

New companies Bill to ensure privately-held, unlisted companies can't escape SEBI scrutiny.

All registered companies, both listed and unlisted, which raise public funds through sale of shares will be answerable to the Securities and Exchange Board of India (SEBI).

The new companies Bill, being formulated by the Ministry of

Corporate Affairs, is expected to make it clear that privately-held and unlisted companies will not be allowed to escape SEBI scrutiny by claiming they are governed by the Registrar of Companies and the Companies Act, and not SEBI rules.

SEBI overhauls key Takeover Code clauses

SEBI has introduced wider open offer exit routes, simplified initial public offer (IPO) application and single Know Your Client (KYC) norms.

HIGHLIGHTS OF SEBI BOARD MEETING
TAKEOVER CODE
1. Open offer trigger increased from 15% to 25%
2. Open offer size increased from 20% to 26%
3. Non-compete fee scrapped
MUTUAL FUNDS
1. Transaction charge of Rs 100 for old customers and Rs 150 for new customers for investment of over Rs 10,000
2. Sebi to allow common set of fund managers and research analysts for different pooled assets like offshore funds and pension funds
3. Sebi to regulate mutual fund distributors
SECONDARY MARKET
1. Unified and simplified know-your-client requirement; aadhar cards eligible for KYC
2. Single signature required to open a trading account instead of more than 50 at present
PRIMARY MARKET
1. IPO form to be simplified
2. Information document with the IPO form to include track record of merchant bankers, comparison with peers

SEBI to frame regulations for alternative investments

Entities promising hefty returns to gullible investors from 'offbeat' avenues like art, antiques and real estate may soon come under the scanner of SEBI, which is framing a new set of rules for 'alternative investments'.

These alternative or offbeat investments are generally offered by wealth or portfolio managers in schemes focused on real estate, art works, antiques and even coins and stamps.

India currently classifies most of these schemes as 'collective investment schemes', which are regulated by SEBI, but a need, has been felt to have a separate set of regulations for 'alternative investments'.

SEBI ask companies to mandatorily file Q4 results

As part of tightening disclosure norms for listed entities, market regulator Securities and Exchange Board of India (SEBI) has made it mandatory for companies to announce their fourth quarter numbers along with audited annual results.

SEBI amends rule to check black money, tax evasion in market

With an aim to check flow of black money and evasion of taxes through stock market, market regulator SEBI has decided to impose hefty penalty on brokers facilitating such transactions from August 1.

Now, promoters asked to disclose share dealings

With an aim to rein in insider trading by promoters without investors' knowledge, SEBI has decided to make it mandatory for all promoter entities to disclose any considerable purchase or sale of shares by them.

SEBI proposes to regulate alternative investment funds

The Securities and Exchange Board of India (SEBI) on August 1 proposed to create regulations for alternative

investment funds under the title SEBI (Alternative Investment Fund) Regulations.

The funds which would come under the proposed regulation include, Venture Capital Funds, PIPE Funds, Private Equity Fund, Debt Funds, Infrastructure Equity Fund, Real Estate Fund, SME Fund, Social Venture Funds, Strategy Fund (Residual Category, including all varieties of funds such as hedge funds, if any).

Exchanges to send SMS, email alerts on trading details

In order to bring in more transparency with regards to allegations of unauthorised trading in investors' accounts by stockbrokers, the Securities and Exchange Board of India (SEBI) in consultation with major stock exchanges and market participants has directed stock exchanges to send details of the transactions to investors by end of trading day through SMS and email alerts.

SEBI's new norms for prior approvals

SEBI on August 3 approved a single-window clearance system for market entities, including stock brokers, merchant bankers and credit ratings agencies, for grant of prior approval for change in control of their management structures.

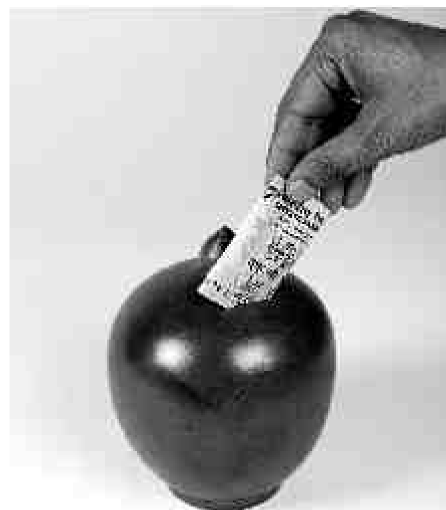
SEBI activates web based complaints redress system

In a bid to better streamline the database, market regulator SEBI has operationalised a centralized web based complaints redress system where all investor complaints would be processed.

SCORES would act as centralized database of all complaints and facilitate online movement of complaints to the concerned intermediaries

SEBI allows QFIs' entry in mutual funds

The Securities and Exchange Board of India (SEBI) on August 9 issued detailed guidelines to allow Know Your Customer-compliant foreign investors, termed as qualified foreign investors or QFIs, to invest in equity and debt schemes in India.



Insurance Sector

Delay in health insurance portability

The IRDA has postponed the date for implementation of health insurance portability by three months to October 1. This is because the insurance industry is taking longer than expected to build a platform to port health policies. IRDA is setting up a web-enabled facility and is urging insurers to have all the details pertinent to health policies of customers on the portal. This would make access to information easy for the customer's new insurer. As health insurance portability kicks off by the deadlines set by the regulator, health insurance policyholders can switch insurers without having to lose on waiting period and no-claim bonus.

IRDA for more companies to participate in pension market

Insurance regulator IRDA on July 22 said that domination of one company in the pension market could be risky and it was important for other insurance companies to participate actively.

According to the IRDA, more than 90 per cent of all the pensions are actually in the LIC. There is a structural problem that will unwind for the regulator and the industry as

a whole, and will affect the country.

Meanwhile, IRDA aims to create a platform on re-insurance, which is more transparent and more like a re-insurance exchange. All matters on re-insurance will be routed only through the exchange. The advantage will be that transactions are clear and there cannot be any glitches in terms of the fine print of the policy.

IRDA tightens solvency guidelines

After a one-year reprieve, the Insurance Regulatory and Development Authority (IRDA) has tightened solvency norms for insurance companies beginning this year itself.

All the insurers will have to comply with a solvency margin of 150 per cent.

Under the guidelines, the insurers would have to raise solvency ratio to 137 per cent this year, 145 per cent the following year and 150 per cent by third year.

Insurers can't walk out of contracts mid-term: IRDA

In a move that will benefit health insurance customers, IRDA has said that companies cannot cancel insurance policies mid-term.

In a circular issued to all companies this week, the Insurance Regulatory and Development Authority said that no policy, either fresh or renewal, can be marketed which has a cancellation clause contrary to the regulations. Regulations allow cancellation only if there is a fraud, misrepresentation or non-disclosure of material fact from the insured.

IRDA scraps 4.5% assured return on pension plans

The Insurance Regulatory and Development Authority (IRDA) has decided to do away with the 4.5 per cent guaranteed annual return clause from pension products. In a draft exposure on the pension plans, the insurance regulator, while allowing more flexibility to insurers, said these products should carry an "assured benefit" disclosed at the time of issuance.

IRDA tightens stake transfer, dilution of ownership in insurance companies

The insurance regulator aims to control transfer and dilution of ownership in insurance companies.

As per the draft guideline, the Insurance Regulatory and Development Authority (IRDA) has proposed a series of measures including mandatory prior approval for anyone to raise stake beyond 5%, and anyone keen to buy 1% or more should seek regulatory approval.

Form asset-liability management policy, IRDA tells insurers

To standardise asset liability management practices followed by insurance companies, the Insurance Regulatory and Development Authority (IRDA) has asked insurers to develop an asset liability management (ALM) policy.

IRDA releases norms for stake transfer by insurance firms

The Insurance Regulatory Authority of India (IRDA) on August 12 made it mandatory for insurers to seek prior approval in case of stake transfer to domestic entities or financial institutions and set guidelines for seeking approval.

As per an IRDA circular, the regulator will carry out the requisite due diligence of the proposed transferee or shareholder prior to grant of approval for registration of transfer of shares under the provisions of section 6A (4) of the Insurance Act, 1938 and for issue of shares to the proposed transferee or shareholder.

GLOBAL ECONOMIC UPDATE

A review of the global economic situation shows that the recovery in some of the advanced economies is still faltering. The moderation in the employment situation in US, re- emergence of sovereign debt crisis in Europe, slowdown in the manufacturing and service sector of China, all point out towards a moderation in the growth prospects of these economies. The IMF in its June update of World Economic Outlook revised the global economic growth forecast to 4.3% for 2011, down by 0.1% relative to April. This figure hides divergent performances for advanced economies on the one hand, and for emerging and developing economies on the other.

IMF Chief Economist, Mr. Olivier Blanchard has indicated three key downside risks to global recovery in the current scenario, (i) the Europe crisis, (ii) risks on the fiscal side in a large number of advanced countries, and (iii) overheating risk in emerging market economies.

Given the fragility in the global economic scenario, the seventh round of FICCI's Economic Outlook Survey was conducted to assess the growth prospects in key advanced economies including the U.S., Euro Area and Japan along with emerging economies of India and China.

The survey results revealed that the U.S. economy is likely to grow by about 2.5 per cent in the year 2011 owing to weak demand [both consumer and business spending] and sluggish investment sentiment. Moderation in government spending is also expected to weaken growth momentum in the months ahead.

Euro area is expected to grow about 1.9 per cent in the current year. Economies within the Euro area are expected to witness significant growth disparities. Western Europe is estimated to grow at a modest 1.5 percent in 2011, but with significant variability. Germany, the Nordic countries (Denmark, Finland, Iceland, Norway and Sweden) along with Benelux countries (Belgium, the Netherlands, and Luxembourg) are expected to perform at the higher end - above 2 percent - while U.K. and France are likely to see growth in the range of 1.5 - 2 percent due to budget cuts and less help from exports. Most of Southern Europe and Ireland are expected to see growth of less than 1 percent or may even contract.

Japan's growth rate is forecasted to fall to a negative 0.5 per cent in 2011. The lingering impact of tsunami, earthquake and the nuclear crisis is expected to lead to a contraction in the Japanese economy.

With regard to **China,** the survey respondents have opined that growth in 2011 would moderate only slightly to about 9.5 as the Chinese economy settles onto a gradually slowing growth trend. The growth moderation will be to a smaller extent only if there are no major negative impacts from inflation or overvalued assets.

GDP projections for 2011 (in %)

Economy	IMF Projection	FICCI EOS Respondent's Forecast		
		Median	Max	Min
US	2.8	2.5	4.0	2.2
Euro area	1.6	1.9	3.0	1.6
Japan	1.4	(-) 0.5	2.0	(-) 0.8
China	9.6	9.5	10	9.0

Source: IMF, World Economic Outlook & FICCI Economic Outlook Survey - 7th Round

GLOBAL DEVELOPMENTS

Moody's Downgrades Japan's Debt Rating

Moody's Investors Service on August 23 downgraded its rating on Japan's debt from Aa2 to Aa3. The new rating is three notches below Moody's top Aaa rating. It said the outlook for the rating is stable.

The agency said it lowered the rating because of Japan's large budget deficits and growing government debt. The downgrade puts Moody's Japan rating in line with other major agencies. Both Standard & Poor's and Fitch rate Japan AA-, three notches below their top AAA ratings.

In May, Moody's warned it could downgrade Japan after the world's third largest economy slipped back into recession in the first quarter of 2011 due to tumbling output and exports following the March 11 earthquake and tsunami.

Europe Short-selling ban

The European Securities and Markets Authority, a body that coordinates the European Union's market policies, on August 11 announced that short-selling of stocks in several countries would be temporarily banned in an effort to stop the tailspin in the markets.

The European market regulator said in a statement that short sales - negative bets on stocks - would be curtailed in France, Belgium, Italy and Spain effective Friday. There is already a temporary short-sale ban in Greece and Turkey.

US Federal Reserve announcement on monetary policy stimulus

The U.S. Federal Reserve on August 9 took the unprecedented step of promising to keep interest rates near zero for at least two more years and said it would consider further steps to help growth. In the announcement, the Federal Reserve said it will keep its monetary policy stimulus at least through 2013. Rates have been near zero since December 2008.

The Fed painted a gloomy picture, saying that U.S. economic growth was proving considerably weaker than expected, inflation should remain contained for the foreseeable and unemployment, currently at 9.1 percent, would come down only gradually.

US Credit Rating Downgrade

The United States lost its top-tier AAA credit rating from Standard & Poor's on August 5 in an unprecedented blow to the world's largest economy in the wake of a political battle that took the country to the brink of default.

S&P cut the long-term U.S. credit rating by one notch to AA-plus on concerns about the government's budget deficit and rising debt burden. The action is likely to eventually raise borrowing costs for the American government, companies and consumers.

S&P said:

- The downgrade reflects our opinion that the fiscal consolidation plan that Congress and the Administration recently

agreed to falls short of what, in our view, would be necessary to stabilize the government's medium-term debt dynamics."

- The outlook on the long-term rating is negative. We could lower the long-term rating to 'AA' within the next two years if we see that less reduction in spending than agreed to, higher interest rates, or new fiscal pressures during the period result in a higher general government debt trajectory than we currently assume in our base case."

Other prominent credit rating agencies - Moody's Investors Service and Fitch Ratings - affirmed their AAA credit ratings even as President Barack Obama signed a bill that ended the debt-ceiling impasse that pushed the Treasury to the edge of default. Moody's and Fitch also said that downgrades were possible if lawmakers fail to enact debt reduction measures and the economy weakens.

Meeting of Heads of State or Government of the Euro area

The meeting of the Heads of State or Government of the Euro area was held on July 21 in Brussels, in order to discuss the financial stability of the Euro area as a whole and the future financing of the Greek programme.

All in all, between the official and the private sector, the EU hopes this new plan can provide around € 147 billion of debt relief to Greece. The EFSF will be allowed to purchase debt in secondary markets; a second bailout package for Greece was agreed lending it €109 billion; the spread in the interest rates on the loans to Greece, as well as to Ireland and Portugal were eliminated and the banks were offered a set of options for them to voluntarily accept default.

EU Stress Test of Banks

The European Banking Authority (EBA) on July 15 released the results of its 2011 EU-wide stress test of 90 banks in 21 countries. The aim of the 2011 EU-wide stress test is to assess the resilience of the banks involved in the exercise against an adverse but plausible scenario.

For the 2011 exercise, the EBA allowed specific capital increases in the first four months of 2011 to be considered in the results. Banks were therefore incentivized to strengthen their capital positions ahead of the stress test.

The 2011 EU-wide stress test results show that:

- At the end of 2010, twenty banks would fall below the 5% Core Tier 1 Ratio (CT1R) threshold over the two-year horizon of the exercise. The overall shortfall would total EUR 26.8 bn.
- Between January and April 2011, a further net amount of some EUR 50 bn of capital was raised.
- Taking into account these capital raising actions implemented by end April 2011
    - ❖ Eight banks fall below the capital threshold of 5% CT1R over the two-year time horizon, with an overall CT1 shortfall of EUR2.5 bn.
    - ❖ Sixteen banks display a CT1R of between 5% and 6%.

On the basis of these results, the EBA also issued its first formal recommendation stating that national supervisory authorities should require banks whose CT1R falls below the 5% threshold to promptly remedy their capital shortfall.

The EBA formally recommended that national regulators should require eight banks that failed the test to raise fresh capital (€2.5 billion) by the end of this year. Also, sixteen additional banks that barely passed the test with the ratios of between 5 and 6 percent need to improve their capital position by April 2012.

FICCI Health Insurance Conference
Theme: "Efficiency in Delivery: Win-Win for Stakeholders"
19th July 2011, "The Lalit", New Delhi

FICCI organized its annual conference on **"Health Insurance" on 19th July, 2011, at The Lalit, New Delhi. The theme of the conference was "Efficiency in Delivery: Win-Win for Stakeholders". Mr J. Harinarayan, Chairman, IRDA delivered the Keynote Address in the Inaugural Session.**

FICCI has been deeply engaged in the Health Insurance space through its Advisory board on Health Insurance supported by senior representatives from IRDA, QCI, Healthcare Providers, the Health Insurance companies, World Bank and other key stakeholders. The focus of this year's conference was to disseminate the work that FICCI's Advisory Board on health insurance has accomplished. This includes:

- **"New Frontiers in Health Insurance Regulation"**
- **"Standardization Initiatives of FICCI Health Insurance forum"**
- **"Promoting Quality in Healthcare through Health Insurance"**
- **"Government Sponsored Schemes in Health Insurance domain"**
- **"Striking win-win partnerships"**

In addition to this, the Conference discussed various Strategies employed towards achieving the universal access to Health Insurance and the way forward to deepen health insurance market.

The Conference participants included representatives from Life Insurance industry, Non- Life Insurance industry, Banking and Financial Services sector, MHIs, NBFCs, Insurance Brokers, Agents.

FIBAC 2011
FICCI-IBA Conference on “Global Banking: Paradigm Shift”
Theme: Productivity Excellence

23rd -25th August 2011, Hotel Trident, Nariman Point, Mumbai

FICCI along with **IBA** organized the **tenth edition of Annual Conference on "Global Banking: Paradigm Shift" (FIBAC)** from **23-25th August, 2011 at Hotel Trident, Nariman Point, Mumbai. The Boston Consulting Group (BCG),** was the Knowledge Partner to the conference. The underlying theme of this year's conference was Productivity excellence, wherein Industry CEO's articulated their challenges and aspirations for the next decade from the Banking fraternity. This significant event in the banking calendar year, provided valuable insights into various business related aspects of banking from the prism of corporate sector's experience.

Dignitaries such as Shri Prithviraj Chavan, Hon'ble Chief Minister of Maharashtra, Dr. D Subbarao, Governor, **Reserve Bank of India, Mr. Paul Koster, Chief executive, Dubai Financial Services Authority, Mr. Tiff Macklem,** Senior Deputy Governor, **Bank of Canada, all Deputy Governors of the RBI along with the who's who of the Banking & Financial sector** graced the occasion and addressed the delegates at the forum. FIBAC is one of the largest and best attended Banking forums in Asia and living up to its expectation, close to 500 delegates including participants and Speakers from over a dozen countries attended the forum this year.

The distinguishing feature of FIBAC this year was that it served as a unique meeting ground and networking platform for the Industry and bankers. To make the most of this, Special Interactive Panel Sessions & Networking Dinners were organized on:

- **23rd August, Large corporate customers - Expectations from banks in next decade**
- **24th August, Interactive Panel Session: SME - Expectations from banks in next decade**

The Interactive Sessions and ensuing Networking Dinners facilitated a prosperous discussion between leading figures from banking fraternity and industrialists on the 23rd August and Leading Bankers and SMEs on the 24th August.

The conference in addition, introduced several exciting features. Some of these were as follows:-

- In depth **Theme Presentations** by lead experts from Boston Consulting Group - the world's renowned consulting firm.
- **Main conference** covering range of issues including Productivity Excellence, Managing people for productivity excellence, Leveraging technology to enhance sales et al.
- FICCI-IBA-BCG Report on ***"Being Five Star in Productivity: Roadmap for Excellence in Indian Banking"*** was released at the Conference.
- In addition, the **Inaugural FIBAC Banking Awards were held on 25th August, 2011** for recognizing the Banks who have achieved significant productivity enhancement under various categories of banking business such as service efficiency, technology, business models, operations excellence, cost efficiency, employee productivity, etc

The conference was a mix of Special Interactive Sessions/ Special Addresses/ Panel Sessions focusing on the following topics:-

- Productivity Excellence in Indian Banking
- Managing people for productivity excellence
- Leveraging technology to enhance sales and cost efficiency
- Interactive Panel Session-Large corporate customers - Expectations from banks in next decade
- Capital efficiency in emerging regulatory climate / impact of Basel III
- Sharper risk assessment and faster collections
- Agriculture finance and productivity
- Service efficiency
- Interactive Panel Session: SMEs - Expectations from banks in next decade
- Future of globalization in banking
- Cost efficient business models for low cost banking
- Operational Excellence

The conference was addressed by some of the leading national and international financial experts. Some of them were as follows:

Stalwarts of Government & Regulators:-

- Dr. D Subbarao, Governor, Reserve Bank of India
- Paul Koster, Chief Executive, Dubai Financial Services Authority
- Mr. Tiff Macklem, Sr. Deputy Governor, Bank of Canada

- Mr. Benedict Ssekabira, Director (Commercial Banking),Bank of Uganda
- Dr. K. C. Chakrabarty, Deputy Governor, Reserve Bank of India
- Dr. Subir Gokarn, Deputy Governor, Reserve Bank of India
- Mr. Anand Sinha, Deputy Governor, Reserve Bank of India
- Mr. H R Khan, Deputy Governor, Reserve Bank of India

Organizing Committee:

- Mr. MV Nair, Chairman, FICCI, Banking & FI's Committee and Chairman and Managing Director, Union Bank of India
- Mr. M D Mallya, Chairman, IBA and Chairman and Managing Director, Bank of Baroda
- Mr K R Kamath, Deputy Chairman, IBA and Chairman and Managing Director, Punjab National Bank
- Mr. Pratip Chaudhuri, Honorary Secretary, IBA and Chairman, State Bank of India
- Ms Chanda Kochhar, Managing Director & CEO, ICICI Bank
- Mr. Neeraj Swaroop, Co-Chair, FICCI's Banking & FI's Committee and Regional Chief Executive, India and South Asia, Standard Chartered Bank
- Mr. Stuart Davis, CEO, HSBC India

Key Speakers

- Ms. Naina Lal Kidwai, Vice President, FICCI and Country Head HSBC India & Director, HSBC Asia Pacific
- Ms. Kaku Nakhate, Managing Director and Country Head - India, Bank of America Merill Lynch
- Mr. Alok Misra, Deputy Chairman, IBA and Chairman and Managing Director, Bank of India
- Mr. S Raman, Chairman and Managing Director, Canara Bank
- Mr. M. V. Tanksale, Chairman and Managing Director, Central Bank of India
- Mr. Pramit Jhaveri, Chief Executive Officer, Citi India
- Mr. Shyam Srinivasan, Managing Director & CEO, The Federal Bank Ltd.
- Mr. T M Bhasin, Chairman and Managing Director, Indian Bank
- Mr. M Narendra, Chairman and Managing Director, Indian Overseas Bank
- Mr. Nagesh Pydah, Chairman and Managing Director, Oriental Bank of Commerce
- Mr. Arun Kaul, Chairman and Managing Director, UCO Bank
- Mr. H S U Kamath, Chairman and Managing Director, Vijaya Bank

FICCI – UNDP Seminar on “Role of Banks in Financial Inclusion”

14th October, 2011, FICCI, Federation House, New Delhi

About the conference:

FICCI in association with UNDP is organising a One day seminar on "Role of Banks in Financial Inclusion" on October 14th 2011 at FICCI, Federation House, New Delhi. This conference is being organised under the aegis of FICCI's Financial Inclusion Committee being chaired by Ms Meera Sanyal, Country Executive India, The Royal Bank of Scotland N.V.

Banks as rightly pointed out in the Raghuram Rajan and Rangarajan committee report have a significant role to play in achieving Financial Inclusion.They need to be at the forefront of any financial Inclusion initiatives with of course, strategic alliances with other stakeholders in the ecosystem.This forum aims to understand the bankers' initiatives and their role in promoting Financial Inclusion and the issues and challenges being faced by them in their endeavour.

"A study on the progress of Financial Inclusion in India" will be released at the Inaugural session of the event. The study aims to on analyse the role played by banks hitherto in creating Financial Inclusion and future strategy they need to adopt to make further progress.

Key Stakeholders:

- Representatives from Banking and Financial Services Sector
- Micro Financial Institution (MFI's),
- Non-Government Organizations (NGOs)
- Self-Help Groups (SHG's)
- Non Banking Finance Companies (NBFC's),
- Policy makers and regulators
- Technology providers
- Community based organizations
- Service Providers
- Consultants
- Researchers

Key Note Address by: Dr K C Chakrabarty, Deputy Governor, Reserve Bank of India

Key Speakers:

- Mr D K Mittal, Secretary, Department of Financial Services, Ministry of Finance*
- Mr Rakesh Singh, Additional Secretary, Department of Financial Services, Ministry of Finance*
- Mr Umesh Kumar, Joint Secretary, Department of Financial Services, Ministry of Finance*
- Ms Naina Lal Kidwai, Vice President, FICCI and Country Head HSBC India & Director, HSBC Asia Pacific
- Ms Caitlin Wiesen, Country Director, UNDP
- Dr Prakash Bakshi, Chairman, NABARD

**Invited*

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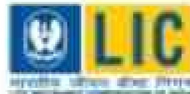

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