Roadmap for financial sector reform

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Re-cap: India was an early starter in finance.

- INR was official currency in some countries in the Middle East until 1960s.
  - Actually, until 1970s in Oman and Muscat!
- BSE was Asia's first stock exchange.
- 1990s saw a burst of activity in the financial space:
  - NSE became first electronic and de-mutualised exchange in India (and one of the earliest ones in the world) (1992).
    - Toronto in 1997, LSE went electronic in 1998 and Tokyo only in 1999!
  - SEBI replaced the Controller of Capital Issues.
  - FEMA replaced FERA.
  - Liberalisation of insurance sector.

To cut a long story short: The 1990s gave us a platform for mobilising savings and channelising them into investments.

Then what happened ...

- Most of India is cut off from the formal financial sector.
  - 90% of small businesses have no links with formal financial institutions.
  - 60% of rural and urban population do not have a functional bank account.[1]
- Under developed bond market.[2]
  - Corporate bond market size = 14% of GDP
  - Bank financing size = 89% of GDP
  - Equity markets = 80% of GDP
- Banks in stress.
- Deficit financing for infrastructure.

[1] Source: Report of the Committee on Comprehensive Financial Services for Small Businesses and Low Income Households (2014)

[2] Computation done by the Finance Research Group, IGIDR

Where are we today? (contd.)

- Rampant mis-selling of financial products.
  - ULIPs, Saradha, etc.
- Governance issues of market infrastructure.
  - NSEL scam.
- Barriers to innovation and competition.
  - Time taken to launch the first equity derivative in India - 4.5 years
  - Time taken to launch a gold ETF - 4 years.[3]

[3] Source: Report of the High Powered Expert Committee on Making Mumbai an Internatinal Financial Centre (2007)

What did we do about this?

Committees set up to study different aspects of the Indian financial sector.

1. Report of the High Powered Expert Committee on Making Mumbai and International Financial Centre (2007) (*Percy Mistry Committee*)
2. Report of the Committee on Financial Sector Reforms (2009) (*Raghuram Rajan Committee Report*)
3. Report of the Working Group on Foreign Investment (2010)
4. Report of the Financial Sector Legislative Reforms Commission (2013) (led by Justice B.N.Srikrishna)
5. Report of the Bankruptcy Law Reforms Commission (2015)

Takeaway: Bulk of reforms required modifying the law.

Some financial sector reform in 2015-16

- Reform of legal framework governing bankruptcy.
- Some reform in the bond market.
- Regulatory convergence of securities and commodities markets.
- Revamping framework for monetary policy:
  - Inflation targeting
  - Institutionalising decision making
- Limited rationalisation of external commercial borrowings.

Have we done enough?

You get what you measure ...

What needs to be fixed?

1. Legal architecture
2. Implementation
3. Governance issues

What still remains?

Legal architecture

1. Legal architecture is still archaic and inadequate, not written for an economy growing at this rate.
2. Inadequate laws.
3. Inconsistent laws.

- We are floundering on implementation.
  Examples:
  1. No real convergence between securities and commodities markets.
  2. Bankruptcy Code enacted, but no corresponding reform of NCLTs on which the Code extensively relies.
  3. Regulation of capital flows not relating to debt moved to MoF, but no progress.

What remains?
Rule of law issues

1. Ad-hoc administration of the law.
2. Regulatory governance.
3. Appeal processes.

Takeaways

Well begun is not necessarily half done ...

1. Measure outcomes, instead of outputs.
2. Distinguish between incremental and structural reforms.
3. Implementation, implementation, implementation.

Thank you