INTRODUCTION
TO
FINANCIAL SYSTEM

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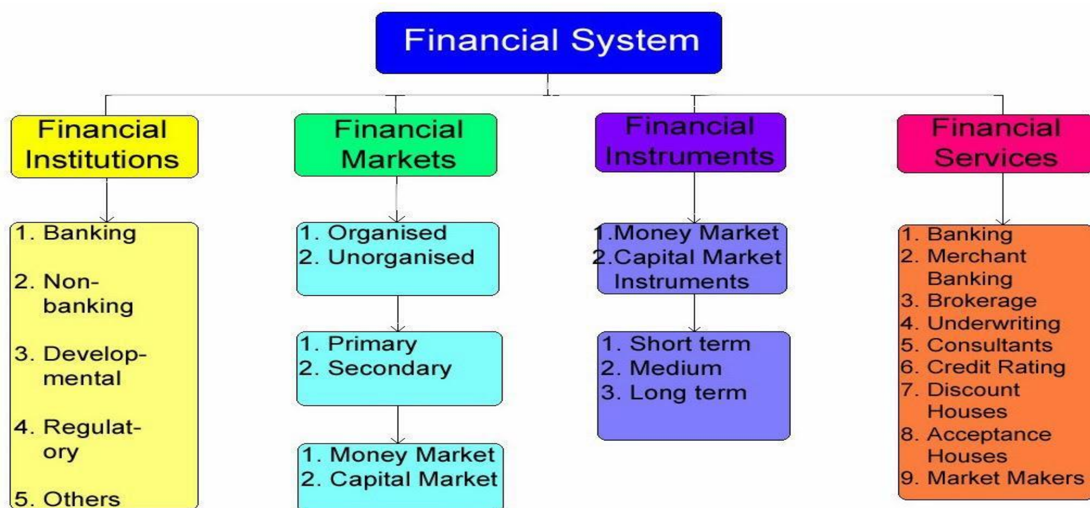
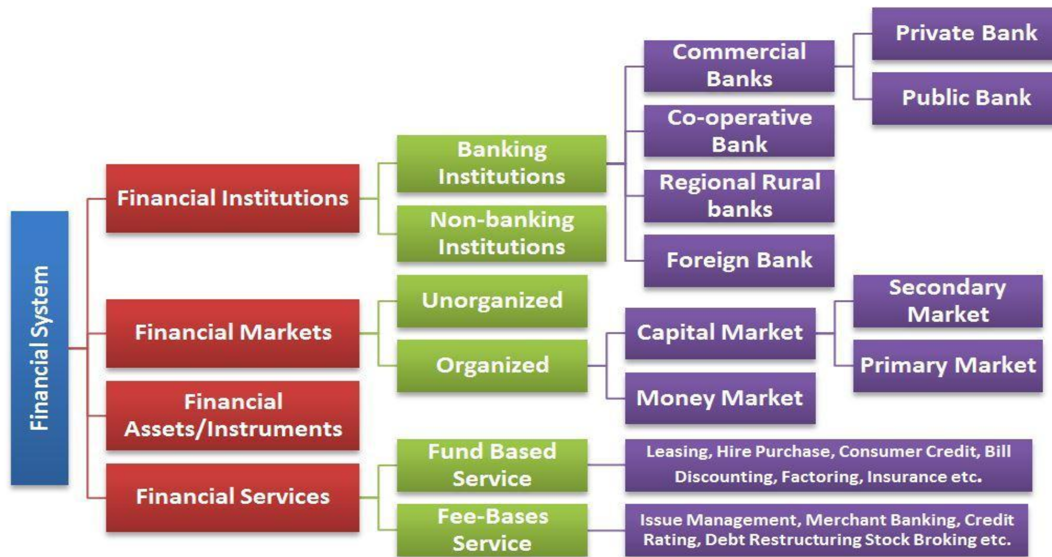
Overview of Financial System

Introduction to the financial system

- The financial system is a system that allows the exchange of funds between financial market participants such as lenders, investors, and borrowers
- The Financial system is a set of complex and closely connected or intermixed institutions, agents, practices, markets, transaction, claims, and liabilities in the economy.
- The financial institution consists of complex, closely related services, markets and institutions intented to provide an efficient and regular linkage between investors and depositors.





- It consists of specialized and non-specialized institutions.
- Eg National bank for agriculture and rural development (NABARD), Industrial development bank of India(IDBI), SIDBI, etc, loans and credits facilities, private education funding, underwriting stocks, and share.
- A well-developed financial system can contribute to the economic development of a country.
- It helps to accelerate the rate of economic development & improves the std of living

Definition

"The financial system is a set of institutional arrangements through which financial surpluses available in the economy are mobilized." - Prof S.B.Gupta.

"The financial system consists of a variety of institutions, markets, and instruments related in a systematic manner provide the principal means by which saving is transformed into investments." - Prof. Prasanna Chandra.

A financial system is a set of systematically integrated constituents that enables the smooth flow of finance from areas of surplus to areas of scarcity in such a way that risk is redistributed and economic development is accelerated.

Thus we can say,

The financial system is composed of several constituents.
All constituents are related to each other.
These constituents come together in the system and mobilize savings.
Savings and the resultant investment lead to economic development.

Role and Importance of financial system

- It mobilizes funds from suppliers and provides these funds to those who demand them.
- In short, it is a mechanism by which savings are transformed into investments.
- It creates an efficient and effective platform for providing finance for production systems.
- It enables the mobilization of savings in a way that facilitates economic growth.
- It links savers & investors.
- It plays a crucial role in economic development through the saving-investment process.
- It helps to monitor corporate performance.
- It provides a mechanism for managing uncertainty and controlling risk.
- It provides a mechanism for the transfer of resources across geographical boundaries.
- It offers portfolio adjustment facilities.
- It promotes the process of capital formation.
- An increase in returns will motivate people to save more.

Functions of Financial System

A financial system is an economic arrangement wherein financial institutions facilitate the transfer of funds and assets between the borrower, lender, and investors.

Its goal is to efficiently distribute economic resources to promote economic growth & generate a return on investment for market participants

Market participants may include investment banks, stock exchanges, insurance companies, individual investors, and other institutions.

FS allows its participant to prosper & reap the benefits.

It also helps in borrowing and lending when needed.

It helps to circulate the funds in different parts of an economy.

Functions of Financial System

Mobilisation of saving

- A financial system helps in mobilizing savings from households through the medium of financial intermediaries.
- When a person opens a savings bank account or invests money in shares it means that they are using the financial system for channeling savings into the economy.

Transformation of saving into capital / Investment

- They are then channelized towards entities/persons who demand finance through the medium of equity or debt.
- The money raised is used to expand operations, start new projects, etc.
- Eg: Tata acquired Corus steel, the acquisition was financed from borrowing money from banks.
- This means banks provided the money that was deposited by persons as savings/ fixed deposits to tata to invest.
- Thus leading to a transformation of saving into capital/investment.

Risk function

- Money gets transferred from saver to enterprises
- The risk of investment does not necessarily get transferred to.
- Eg: when a bank uses public deposits to lend to institutions, it is passing on the funds from savers to borrowers.
- However, if the borrower does not repay the bank, the bank bear the loss also provides protection against life, health, and income risk.

- These guarantees are accomplished through the sale of life, health insurance, and property insurance policies.
- Thus FS protects investors from various financial risks through insurances and other types of contracts.

The liquidity function

- Financial System makes sure that one can liquidate his or her savings whenever he or she wants it.
- The financial market gives investors the ability to reduce the risk by providing liquidity.
- It thus allows for easy buying & selling of assets when needed.

Economic development

- By transforming savings into capital & redistributing risk, the Financial System enables smooth flow of funds to productive & scarce areas.
- This leads to high production & increase in employment & consumer dd.
- Accordingly, more goods are available & more people are willing to purchase them.
- This creates a healthy cycle of economic development.

Payment function

- The Financial System offers a very convenient mode of payment for goods and services.
- An efficient payment system allows businesses and merchants to collect money in exchange for their products or services.
- Payment can be made with cash, cheques, credit cards.
- The cheque system & credit card system are the easiest methods of payment in the economy.
- The cost & time of the transaction is considerably reduced.

Government policy

- Government attempts to stabilize or regulate an economy by implementing specific policies to deal with inflation, unemployment & interest rate.

Evolution of financial system

- At the time of independence in 1947, there was no strong financial institution mechanism in the country.
- The industrial sector had no access to the saving of the community.
- The Private & unorganized sectors played an important role in the provision of liquidity.
- After independence, a scheme of planned economic development was evolved in 1951 with a view to achieving economic & social objectives.
- The Government started creating new financial institutions to supply finance both for the agricultural sector & industrial sector.
- Govt also started nationalizing some important financial institutions so that the flow of finance might be in the right direction.
- The evolution of IFS can be classified into 3 phases.

Following development took place in IFS:

Phases 1: The Pre Independence Phase

- There were almost 600 banks in India before independence.
- The 1st bank to be established as the Bank of Hindustan was founded in 1770 in Calcutta. It closed down in 1832.
- There were various banks that evolved post to Hindustan bank such as General Bank of India (1786 -1791) & Oudh Commercial Bank (1881 – 1958).
- The Oudh Commercial Bank is India’s 1st commercial bank in the history of the evolution of banking in India.
- However, these banks were not able to continue for a long time.
- Few banks of the 19th century are existing even today such as Punjab National Bank formed in 1894 & Allahabad Bank formed in 1865.
- Some other banks like Bank of Bengal, Bank of Madras, Bank of Bombay- established in the early to mid -the 1800s – were merged as one to become The Imperial Bank, which later became the State Bank Of India.
- During this phase, The Bombay Stock Exchange was also established in 1875.
- It is Asia’s 1st stock exchange.
- It helped to develop India’s capital market.
- The Hilton Young Commission in 1935 recommended the establishment of the RBI.

Phases 2: The Post-Independence Phase

- This period is characterized by the nationalization of banks.
- The majority of the banks were private & were serving only the big corporations.
- The rural population, small-scale industries & agriculture sector were still dependent on local money lenders.
- To overcome this situation the government decided to nationalize the banks under the banking regulation act 1949.
- RBI was nationalized in 1949.
- Later on, 14 commercial banks were nationalized in July 1969 during the tenure of Indira Gandhi.
- Narasimham committee in 1975 recommended the establishment of RRBs (Regional Rural Banks) for the development of the rural sector and providing services to unserved ones.
- There were several other specialized banks that were constituted during this period to support the development of the economy. These were NABARB in 1982 for supporting agricultural-related activities, National housing bank in 1988 for the Housing sector, SIDBI in 1990 for assisting small-scale firms.
- Nationalization was a remarkable step in the banking industry which boosted the country's growth. It was successful in gaining people’s confidence in banking services and also smaller groups were easily able to access capital from financial institutions post-nationalization.

Establishment of development banks

- In 1949, RBI undertook a detailed study to find out the need for specialized institutions.
- The first development bank was established in 1948.
- It was the Industrial Finance Corporation of India (IFCI).
- The Industrial Credit & Investment Corporation of India (ICICI) was set up in 1955. It was supported by the Govt of India, the World Bank, etc.
- The UTI (Unit Trust of India) was established in 1964 as a public sector institution to collect savings of the people and make them available for productive ventures.
- The Industrial Development Bank of India (IDBI) was established on 1 July 1964 as a wholly-owned subsidiary of RBI.
- On 16 Feb 1976, it became an independent financial institution.

- It coordinates the activities of all other financial institutions.
- In 1971, the IDBI & LIC jointly set up the Industrial Reconstruction Corporation of India with the main objective of reconstruction & rehabilitation of sick industries.
- It was renamed as Industrial Reconstruction Bank of India in march 1985 but now its name is Industrial Investment Bank of India (IIBI).
- In 1982 Export-Import Bank of India (EXIM Bank) was set up to provide financial assistance to exporters & importers.
- On 2nd April 1990, the Small Industries Development Bank of India(SIDBI) was set up.
- It has taken over the responsibility of administering the Small Industries Development fund & National Equity Fund.
- Its primary function is for promoting, developing & financing MSME.

Establishment of Institution for Agricultural Development

- In 1963, RBI set up Agricultural Refinance & Development Corporation (ARDC) to provide refinance support to banks to finance major development projects, minor irrigation, farm mechanization, land development, etc.
- NABARD was set up in 1982 to meet the credit needs of the agriculture & rural sector.
- It provides short-term, medium-term, & long-term finance to agriculture & allied activities.

Establishment of Institution for Housing Finance

The National Housing Bank (NHB) was set up in July 1988 as an apex institution to mobilize resources for the housing sector & to promote housing finance institutions.

Establishment of Stock Holding Corporation of India (SHCIL)

- In 1987, Stock Holding Corporation of India ltd. was established to strengthen the stock & capital markets in India.
- Its main objective is to provide quick share transfer facilities, clearing services, support services, etc. to investors.
- Establishment of Mutual funds & venture capital institutions.

- Mutual funds refer to the funds raised by financial service companies by pooling the savings of the public & investing them in a diversified portfolio.
- Venture capital is a long-term risk capital to finance high technology projects.
- IDBI venture capital fund was set up in 1986.
- ICICI & UTI jointly set up the Technology Development & Information Company of India Ltd. in 1988 to provide venture capital.

Phases 3: The Liberalisation Era

- IFS has undergone massive changes since the announcement of the New Economic Policy 1991.
- LPG has transformed the Indian economy from a closed to an open economy.
- The corporate industrial sector also has undergone changes due to delicensing of industries, financial sector reforms, capital market reforms, disinvestment in public sector undertaking, etc.
- Public or development financial institutions have been converted into companies, allowing them to issue equity/ bonds to the public.
- The Government has allowed the private sector to enter into the banking & insurance sector.
- Foreign companies were also allowed to enter the insurance sector in India.

Constituents of Indian Financial System

Following are the constituents of IFS:

- Financial institutions
- Financial markets
- Financial instruments
- Financial services

Financial institutions

The Financial Institutions act as a mediator between the investor and the borrower. The investor's savings are mobilized either directly or indirectly via the Financial Markets.

Financial institutions are the business organizations that act as mobilizers and depositories of savings.

This means financial institutions mobilize the savings of savers and give credit or finance to the investors.

They also provide various financial services to the community.

The best example of a Financial Institution is a Bank. People with surplus amounts of money make savings in their accounts, and people in dire need of money take loans. The bank acts as an intermediate between the two.

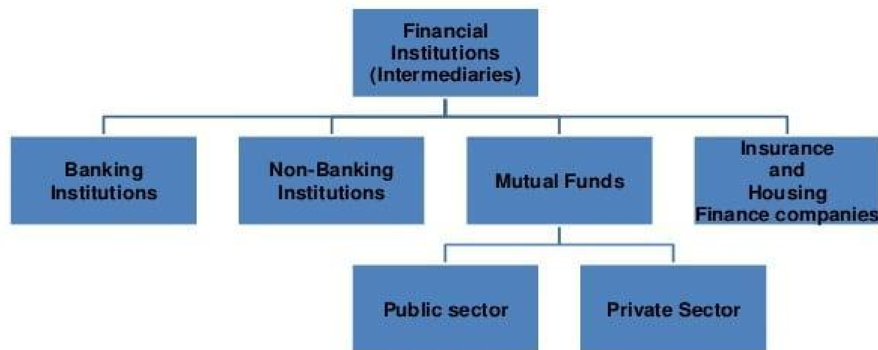
The financial institutions can further be divided into two types:

- **Banking Institutions or Depository Institutions** – This includes banks and other credit unions which collect money from the public against interest provided on the deposits made and lend that money to the ones in need.
- **Non-Banking Institutions or Non-Depository Institutions** – Insurance, mutual funds, and brokerage companies fall under this category.

Further, Financial Institutions can be classified into three categories:

- **Regulatory** – Institutes that regulate the financial markets like RBI, IRDA, SEBI, etc.
- **Intermediates** – Commercial banks which provide loans and other financial assistance such as SBI, BOB, PNB, etc.
- **Non Intermediates** – Institutions that provide financial aid to corporate customers. It includes NABARD, SIBDI, etc.

Financial Institutions



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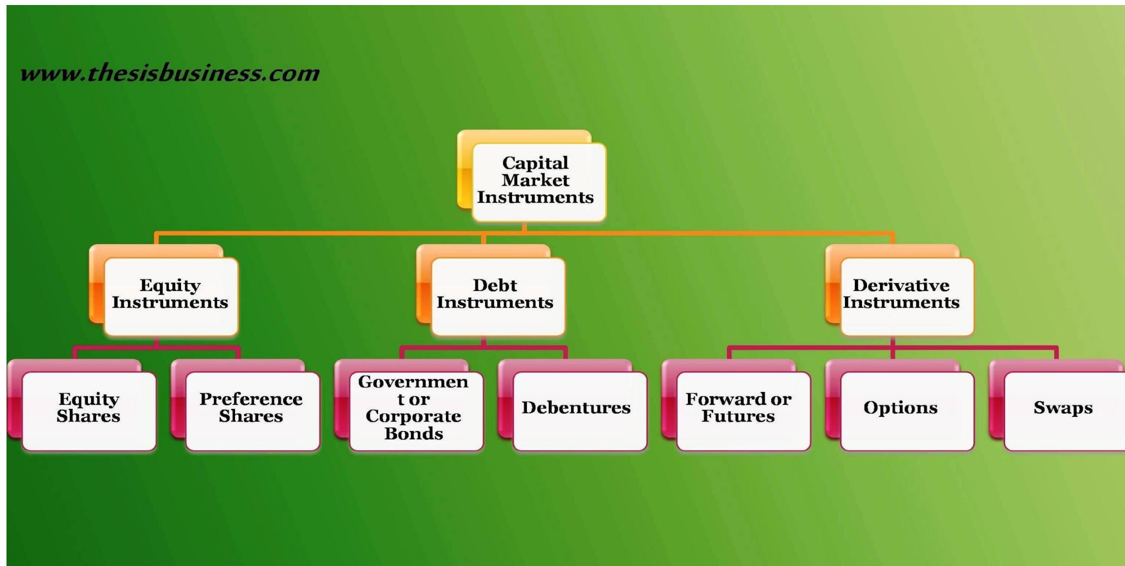
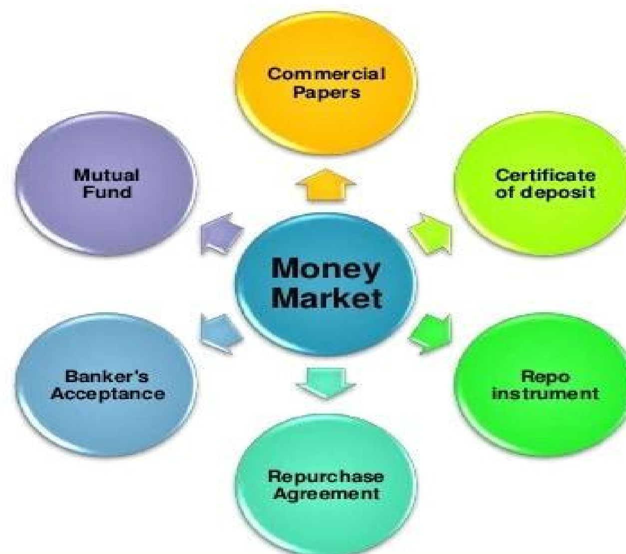
Financial market

- The marketplace where buyers and sellers interact with each other and participate in the trading of money, bonds, shares, and other assets is called a financial market.
- Financial markets are another part or component of the financial system.
- Financial markets are the backbone of the economy.
- The ultimate goal of the financial system is to accelerate the rate of economic development.
- This is done by establishing a bridge between savers & investors.
- This encourages both saving & investments.
- A financial market is that part of the financial system which acts as a platform for the exchange of financial services & instruments.
- They provide monetary support for the growth of the economy.
- Participants are financial institutions, agents, brokers, dealers, borrowers, etc.
- Financial markets can also be classified as money markets & capital markets.
- Capital market can be classified as a primary & secondary market.
- The primary market deals in new financial securities therefore it is called a new issue market.
- Secondary market deals in securities already issued or existing securities. Eg., stock exchange.
- Financial markets can also be classified as money markets & capital markets.
- The money market deals with short-term claims with a maturity of less than one year.

- Capital market deals with long-term claims i.e. more than one year.





Financial instruments

- The financial system deals in financial services & claims are known as financial instruments, or financial assets or securities.
- Financial instruments can be classified as primary & secondary instruments.
- The primary instruments are issued by the ultimate investors directly to the savers as in the case of ordinary shares, debentures, or bonds where the companies are investors & people who buy instruments are savers.
- The important characteristics of financial instruments are transferability, liquidity, tax exemption.
- There are varieties of instruments like treasury bills, commercial bills, commercial papers, certificates of deposits, postal saving instruments, etc.
- The products which are traded in the Financial Markets are called Financial Assets.
- Based on the different requirements and needs of the credit seeker, the securities in the market also differ from each other.

Some important Financial Assets have been discussed briefly below:

- **Call Money** – When a loan is granted for one day and is repaid on the second day, it is called call money. No collateral securities are required for this kind of transaction.
- **Notice Money** – When a loan is granted for more than a day and for less than 14 days, it is called notice money. No collateral securities are required for this kind of transaction.
- **Term Money** – When the maturity period of a deposit is beyond 14 days, it is called term money.
- **Treasury Bills** – Also known as T-Bills, these are Government bonds or debt securities with maturity of less than a year. Buying a T-Bill means lending money to the Government. It can be issued for 91/182/364 days.
- **Certificate of Deposits** – It is a dematerialized form (Electronically generated) for funds deposited in the bank for a specific period of time. (3 or 6 or 12 months).
- **Commercial Paper** – It is an unsecured short-term debt instrument issued by corporations. They usually have a fixed maturity period from 1 to 270 days.

Financial services

- Services provided by Asset Management and Liability Management Companies.
- They help to get the required funds and also make sure that they are efficiently invested.

The financial services in India include

- **Banking Services** – Any small or big service provided by banks like granting a loan, depositing money, issuing debit/credit cards, opening accounts, etc.
- **Insurance Services** – Services like issuing of insurance, selling policies, insurance undertaking, brokerages, etc. are all a part of the Insurance services.
- **Investment Services** – It mostly includes asset management.
- **Foreign Exchange Services** – Exchange of currency, foreign exchange, etc. are a part of the Foreign exchange services.
- The main aim of financial services is to assist a person with selling, borrowing, or purchasing securities, allowing payments and settlements and lending and investing.
- There is a multitude of financial services which help in financial intermediation.
- The financial services can broadly be divided into 2 parts.
- Those services are provided by govt & the services provided by private parties be it investment banks or broking companies such as Motilal Oswal edelweiss, sharekhan, angel broking, etc who provide capital market trading services.
- These constituents provide fee-based services to the participants of the financial system.

The interrelationship between components of financial system

- Financial system is a set of complex & closely interlinked financial institutions, financial institutions, financial market, financial instruments & services which facilitate the transfer of funds.
- Financial markets channel funds from those who save to those who wish to make capital investments.
- The financial market can also be divided into money & capital markets.
- These instruments, if issued in the money market, have a maturity of less than 1yr.
- Eg treasury bills, commercial paper, bank certificates of deposit, etc.
- And if issued in the capital market have maturities equal to or greater than 1yr ie shares, debentures.
- Trading of these instruments takes place with the help of middlemen between borrower & lender.
- Financial intermediaries serve to reduce problems associated with asymmetric information in financial transactions.
- Investors could also invest in financial systems through financial institutions such as commercial banks, saving banks, insurance companies, pension funds, mutual funds, finance companies, brokers & investment banks.
- Thus financial markets, intermediaries, instruments & institutions are interrelated, instruments & institutions are interrelated to each other contributing to the development of the economy.

Financial system in India compared with developed countries

- India has 23 recognized stock exchanges that operate under government approved rules by-laws & regulations.
- India's financial system is relatively small.
- The financial depth of India is comparatively low.
- A low level of intermediates indicates that the financial system is not playing a large role in allocating capital driving growth in India.

There are 3 factors explaining the causes of low financial dept:

- Firstly, households invest just half of their savings in bank deposits & other financial assets, 30% of the rest in housing & 20% in tiny household enterprises, most with very low productivity.
- Secondly, India's corporate market is tiny.
- Thirdly, low bank lending.

The government's tight control of India's financial system largely explains its poor allocation of capital.

While the extent of integration between capital markets and other segments of financial markets is much deeper in the developed economies.

In India, there have been some episodes of volatility spillover between markets in times of uncertainty.

In view of the progressive integration of various segments of financial markets, the reserve bank keeps a close watch on activity in the equity market to guard against any possible spillover of disturbances to the money, the government securities & the foreign exchange markets.

In some markets, such as US & UK financial markets dominate the financial system, whereas, in France, Germany, Japan, China, India banks have played the most important role.

Financial Markets

- The economic development of a nation largely depends on the existence of a sound financial system.
- The financial system provides the funds for the production & distribution of goods & services which in turn facilitates the economic growth of a nation.
- Efficient functioning of the financial system enables the proper flow of funds from savers to productive activities.
- One of the important constituents of the financial system is the Financial market
- The marketplace where buyers and sellers interact with each other and participate in the trading of money, bonds, shares, and other assets is called a financial market.
- Financial markets are another part or component of the financial system.
- Financial markets are the backbone of the economy.
- The ultimate goal of the financial system is to accelerate the rate of economic development.
- This is done by establishing a bridge between savers & investors.
- This encourages both saving & investments.
- A financial market is that part of the financial system which acts as a platform for the exchange of financial services & instruments.

Structure of Financial market

Financial market is divided into two groups –

- Money market
- Capital market

Money market which provides short term funds.
The capital market which provides long-term funds.

Money market

It is a market for short-term funds i.e. for the period of up to 1 year.

The fund generated from the money market can be utilized for the working needs of the borrower.
Money market id further divided into-

- Unorganised Money market.
- Organized Money market.

Unorganized Money Market

There are no standardized rules & regulations relating to financial dealings.

The participants do not follow the regulation of RBI relating to the rate of interest, capital adequacy ratio.

Participants are as follows:
- Moneylenders.
- Indigenous bankers.
- Chit funds.
- Non-banking finance companies.
- Individuals & others

Organised money market

The organized money market follows standardized rules and regulations.

Participants are:- RBI, Banks, Corporates, Non-banking companies which follows rules & regulation of the Govt /RBI.

Instruments are as follows:-
- Treasury bills.
- Certificate of deposit.
- Commercial paper.
- Call the money market.
- Commercial bill market.

Notice Money – When a loan is granted for more than a day and for less than 14 these days, it is called notice money. No collateral securities are required for this kind of transaction.

Term Money – When the maturity period of a deposit is beyond 14 days, it is called term money.

Role & functions of money market

Money markets are wholesale markets of short-term debt instruments.

Money markets are networks of buyers & sellers connected through telecommunication lines.

Trading is conducted over the telephone /internet.

Role & functions:

- A money market is generally expected to perform 3 broad roles.
- Provides short-term funds access at an efficient price.
- Provides a mechanism to even out the demand-supply of short–term funds.
- Provide a central point for RBI's intervention for influencing money supply and interest rates in the economy.
- A liquid and vibrant money are necessary for the development of other market segments.
- The money market contributes to the economic stability and development of a country by providing short-term liquidity to governments, commercial banks, and other large organizations. Investors with excess money that they do not need can invest it in the money market and earn interest.

Following are some of the functions of an efficient money market in an economy:

Provides a stable source of short-term funds to banks

- The money market provides quick & stable liquidity for banks in case of emergency.
- Banks do not need to tap RBI for meeting reserve shortfalls if money markets are vibrant.
- The money market allows banks to better manage interest rate risks and asset-liability mismatches.

Facilitates govt market borrowing

- Better liquidity in the money market facilitates short-term government borrowing and supports long-term government borrowing as well.
- The government can achieve better pricing on its debt as the deep money market facilitates borrowing through access to a wide range of investors.

Effective monetary policy actions

- Money markets also help RBI to implement monetary policy.
- Central banks use the money market as OMO platforms & for transmission of increase or decrease in interest rates.

Help in pricing different floating interest products

- The short-run interest rate of the money market serves as an indicator of the long-run interest rates, in this way; they help in the pricing of long term & floating interest products & the building of an effective yield curve.

Financing Trade

- The money market provides financing to local and international traders who are in urgent need of short-term funds. It provides a facility to discount bills of exchange, and this provides immediate financing to pay for goods and services.
- International traders benefit from the acceptance houses and discount markets. The money market also makes funds available for other units of the economy, such as agriculture and small-scale industries.

Central Bank Policies

- The central bank is responsible for guiding the monetary policy of a country and taking measures to ensure a healthy financial system. Through the money market, the central bank can perform its policy-making function efficiently.
- For example, the short-term interest rates in the money market represent the prevailing conditions in the banking industry and can guide the central bank in developing an appropriate interest rate policy. Also, the integrated money markets help the central bank to influence the sub-markets and implement its monetary policy objectives.

Growth of Industries

- The money market provides an easy avenue where businesses can obtain short-term loans to finance their working capital needs. Due to the large volume of transactions, businesses may experience cash shortages related to buying raw materials, paying employees, or meeting other short-term expenses.
- Through commercial paper and finance bills, they can easily borrow money on a short-term basis. Although money markets do not provide long-term loans, it influences the capital market and can also help businesses obtain long-term financing. The capital market benchmarks its interest rates based on the prevailing interest rate in the money market.

Commercial Banks Self-Sufficiency

- The money market provides commercial banks with a ready market where they can invest their excess reserves and earn interest while maintaining liquidity. Short-term investments, such as bills of exchange, can easily be converted to cash to support customer withdrawals.
- Also, when faced with liquidity problems, they can borrow from the money market on a short-term basis as an alternative to borrowing from the central bank. The advantage of this is that the money market may charge lower interest rates on short-term loans than the central bank typically does.

The capital market

- Capital market may be defined as a market dealing in medium & long-term funds.
- It is an institutional arrangement for borrowing medium & long-term funds and which provides facilities for marketing & trading of securities.
- So it constitutes all long-term borrowings from banks & financial institutions, borrowings from foreign markets & raising of capital by issuing various securities such as shares, debentures, bonds, etc.
- Securities have a maturity of one year or more.
- The market where securities are traded is known as the securities market.
- The capital market is divided into primary market & secondary market.
- The primary market deals with new or fresh issue markets & therefore called new issue markets.
- The secondary market provides a place for the purchase & sale of existing securities & it is often termed as the stock market or stock exchange.
- The secondary market comprises the equity market & the debt markets.
- The equity market is the trading of equity instruments.
- Eg of an equity instrument would be security that signifies ownership in a company & represents a claim on part of the company's asset or earning.
- The debt market is the market where debt instruments are traded.
- Debt instruments are assets that require a fixed payment to the holder, usually with interest.
- Eg of debt instruments includes bonds & debentures.

Characteristics of the capital market

- It is a vehicle through which capital flows from the investors to borrowers.
- It generally deals with long-term securities.
- All operations in the new issues & existing securities occur in the capital market.
- It deals in many types of financial instruments like equity shares, preference shares, debentures, bonds, etc.
- These are known as securities. It is for this reason that the capital market is known as the Securities Market.
- It functions through a number of intermediaries such as banks, merchant bankers, brokers, underwriters, mutual funds, etc.
- They serve as a link between investors & borrowers.
- The constituents or players include individuals & institutions.
- They include individual investors, Investment & trust companies, banks, stock exchanges, specialized financial institutions, etc.

Role of capital market

Mobilisation of savings

- Capital market helps in mobilizing the savings of the country.
- It gives an opportunity to the individual investors to employ their savings in more productive channels.

Capital formation

- Large amount is required to invest in infrastructure foundation.
- Such a large amount cannot be collected from one individual or a few individuals.
- The capital market provides an opportunity to collect funds from a large number of people who have an investible surplus.

Economic development

- Idle funds of the saver are channelized to the productive sectors.
- Help in rapid industrialization & economic development of a country.

Integrated different parts of the financial system.

Promotion of stock market

Foreign capital

Economic welfare

Innovation

Functions of the capital market

- To mobilize resources for investments.
- To facilitate buying & selling of securities.
- To facilitate the process of efficient price discovery

Primary market

- Primary market is a new issue of securities, which are issued to the public for the first time.
- It is called the new issue market.
- The primary market consists of arrangement, which facilitates the procurement of long-term funds by companies by making fresh issues of share & debenture.
- Companies make fresh issues at the formation stage & if necessary subsequently for expansion of business.

Features of primary market

- The first important feature of the primary market is that it is related to the new issues.
- Whenever a company issues new shares or debentures it is known as IPO (Initial Public offer).

- The main players of primary markets are the private & public companies that offer equity or debt-based securities such as stocks and bonds in order to raise money for their operations such as business expansion, modernization & so on.
- Primary market transactions are carried out before secondary market operations.
- There are various methods of raising funds from the primary market: public issue, tender offer, private placement, and offer for sale

Functions of primary market

The main function can be divided into 3 service functions:

1) Origination

It refers to the investigation & analysis and processing of new project proposals.
Origination begins before an issue is floated in the market.
There are 3 elements of origination function:

- The preliminary investigation involves a detailed study of economic, financial, legal, technical & environmental aspects, to ensure the soundness of the project.
- In the process of origination, the sponsoring institutions perform a second function, which is advisory in nature.
- The advisory services improve the quality of capital issues.

The advisory services include:
- Type of issue ie. The type of securities to be issued – shares, debentures, etc.
- The timing & the size (amount) of the issue.
- Pricing of issue ie. The issue is at par or premium.
- Method of issue, ie. Public issue, offer for sale, private placement, etc.

The origination is done by merchant bankers, who may be banks or FIs, or private investment firms.

Although origination is very important, the success of the new issue largely depends on the financial climate and efficiency of capital markets.

2) Underwriting

Origination by itself does not guarantee the success of the new issue.

When a company issues shares to the public it is not sure that the whole shares will be subscribed by the public.

Therefore in order to ensure the full subscription of shares or to ensure the success of new issues the company has to appoint underwriters.

It is a contract between a company & an underwriter by which he agrees to undertake that part of shares or debentures which has not been subscribed by the public.

The firm or persons who are engaged in underwriting are called underwriters.

The underwriters can be banks or FIs or specialized underwriting firms.

The underwriters guarantee the minimum subscription.

The main advantages of underwriting are:

- The issuing company is assured of raising adequate capital.
- Underwriters may provide advisory services such as the timing of issuing, pricing of issue, the size of the issue, etc.
- Public confidence is enhanced, if the issue is underwritten by reputed underwriters.

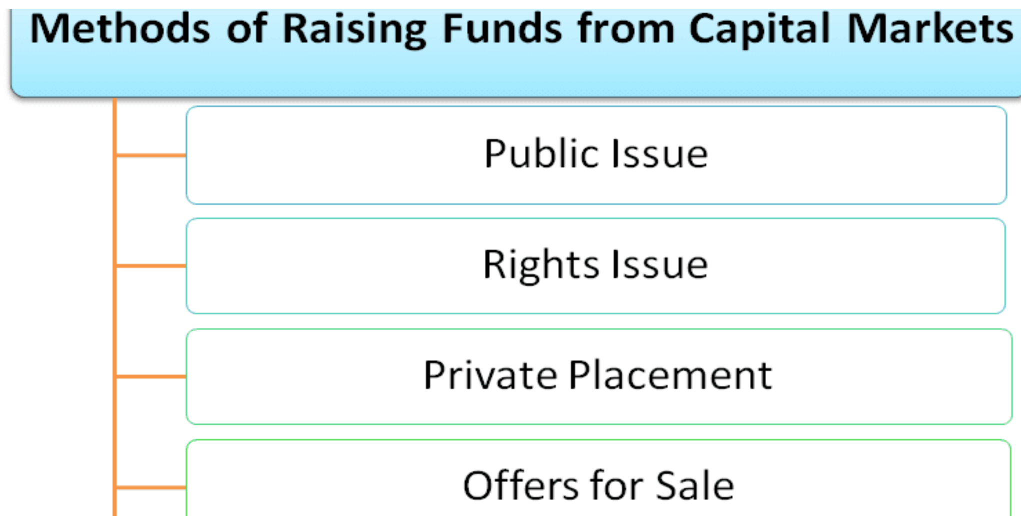
3)Distribution

Underwriting is a stop-gap arrangement to guarantee the success of a new issue.

In the final analysis, the success of a new issue depends on the issue being subscribed by the public.

Therefore, there is a need for the effective sale of the shares or debentures offered to the public, if the issue is not fully subscribed by the public.

Underwriters may be financial institutions, banks, mutual funds, brokers, etc.



Mode of primary market issuance

Raising Funds from the Primary Market

Below are some of the ways in which companies raise funds from the primary market:

1) Public Issue

- This is the most common way to issue securities to the general public. Through an IPO, the company is able to raise funds. The securities are listed on a stock exchange for trading purposes.
- Entities issue securities to the public usually through an initial public offering (IPO) in which securities of a company are sold to the general public for the 1st time.
- Through this process, a Pvt co. is transformed into a public co.
- Post IPO shares trade freely in the open market.
- Details of the proposed issue are disclosed to potential purchasers through a prospectus.

2) Rights Issue

- When a company wants to raise more capital from existing shareholders, it may offer the shareholders more shares at a price discounted from the prevailing market price.
- The number of shares offered is on a pro-rata basis.
- This process is known as a Rights Issue.
- This is done to reward loyal shareholders of the company.
- The existing shareholders can choose not to exercise their right & sell this right to someone else.

3) Private placement

- Private placement is a non-public offering of securities.
- This is a Pvt. The offering of securities to selected few large investors.
- Private placement investors are usually large banks, mutual funds, insurance companies, other funds & large companies.

4)Preferential issue

- A preferential issue is an issue of shares or of convertible securities by listed companies to a select group of investors(neither right or public issue).
- When a listed company issues shares to a few individuals at a price that may or may not be related to the market price, it is termed a preferential allotment.
- The company decides the basis of allotment and it is not dependent on any mechanism such as pro-rata or anything else

5) Offer for sale

- A private company launches an initial public offering for additional funding.
- The co. sells shares to outside investors so that it can gain access to funds for various purposes.
- This includes the growth & expansion of the company.
- However, the company's financial problems do not end with an IPO. Sometimes a company may need additional capital to meet its goals.
- That's the time co. opt to go for an OFS.
- The promoter of a co. dilute their stake by selling their share on an exchange platform.
- Those who want to buy can bid on these shares.

Players or participants in the primary market or capital market:

Merchant bankers
Merchant bankers play a vital role in attracting public money to capital issues. They act as issue managers or co-managers.

Registrars to the issue
Registrars are intermediaries who undertake all activities connected with new issue management. They are appointed by the company in consultation with the merchant bankers to the issue.

Bankers
Some commercial banks act as collecting agents & some act as coordinating bankers. Some bankers act as merchant bankers and some are brokers. They play an important role in the transfer, transmission & safe custody of funds.

Brokers
They act as intermediaries in the purchase & sale of securities in the primary & secondary markets. They have a network of sub-brokers spread throughout the country.

Underwriters
Generally investment bankers act as underwriters. They agreed to take a specified number of shares or debentures offered to the public if the issue is not fully subscribed by the public. Underwriters may be financial institutions, banks, mutual funds, brokers, etc.

Secondary market

The secondary market known as the stock market or stock exchange plays an equally important role in mobilizing long-term funds by providing the necessary liquidity to hold in share & debentures.

It provides a place where these securities can be encashed without any difficulty & delay.

It is an organized market for the purchase and sale of securities of joint-stock companies, govt & semi- govt bodies.

It is the center where shares, debentures & govt securities are brought & sold.

The securities contract regulation act 1956, defines a stock exchange as ***"an association, organization or body of individuals whether incorporated or not, established for the purpose of assisting, regulating & controlling of business in buying, selling & dealing in securities."***

BSE- Bombay Stock Exchange is the oldest stock exchange in India & Asia set in 1875.

However, at present, the largest volume of trading takes place on National Stock Exchange (NSE).

Characteristics of stock exchange

- It is an organized capital market.
- It is an open market for the purchase & sale of securities.
- Only listed securities can be dealt with on a stock exchange.
- It works under established rules & regulations.
- The securities are bought & sold either for investment or for speculative purposes.
- The IPO is primarily sold on the primary market, but after that, they are traded in secondary markets.
- It is possible to purchase as many shares as he/she wants in the financial marketplace.

The function of stock exchange:

Liquidity

The stock exchange provides a place where shares & stocks are converted into cash.

People with surplus cash can invest in securities & people with deficit cash can sell their securities to convert them into cash.

The continuous market for securities

It provides a continuous & ready market for buying & selling securities.

It provides a ready market for those who wish to buy & sell securities

Mobilisation of saving

It helps in mobilizing savings & surplus fund of individuals, firms & other institutions.

It directs the flow of capital in the most profitable channel.

Capital formation

The stock exchange publishes the correct prices of various securities.

Thus the people will invest in those securities which yield higher returns.

It promotes the habit of saving & investment among the public.

Economic development

It promotes industrial growth & economic development of the country by encouraging industrial investments.

New & existing concerns raise their capital through stock exchanges.

Safeguards for investors

Interests of the investors are very much protected by the stock exchange.

The brokers have to transact their business strictly according to the rules prescribed by the stock exchange.

Hence they cannot overcharge the investors.

Acts as a clearinghouse of securities

It acts as a clearinghouse of securities.

It facilitates easy & quick clearance of transactions between the buyer & sellers of securities on the stock exchange

Listing of securities

The stock exchanges facilitate listing of securities issued by public limited companies.

The companies that issue shares to the public can get their share listed on one or more stock exchanges in the country.

The listing of shares is done through a listing agreement.

The listing agreement is signed by the issuing company and the concerned stock exchange

Suspension of securities from trading

A stock exchange may suspend or withdraw certain listed securities from trading.

The suspension or delisting of securities is done when a particular listed company does not follow the rules & regulations.

Settlement of claims or disputes

A stock exchange may prescribe the procedure for the settlement of claims or disputes between the buyer & seller of securities.

It monitors the settlement of claims or disputes.

Imposes fines & penalties

A stock exchange may impose fines and penalties on its broker members, who do not follow its rule & regulation.

Before imposing fines & penalties, the stock exchange gives a reasonable opportunity to its members to correct discrepancies.

Registration of brokers

The stock exchange registers the brokers for membership.

Such registration is required for the purpose of trading securities on the exchange.

Apart from registration with the stock exchange, brokers also need to register with SEBI.

Maintaining records

Every recognized stock exchange and its members must maintain such books of account & other documents as prescribed by the central government.

The books of account and other documents may be inspected by SEBI.

The relevant books of account & other documents must be preserved for a period of 5 yrs.

Filing of periodical returns with SEBI

Every recognized stock exchange furnishes to the SEBI such periodical returns relating to its affairs.

Mode of secondary market trades

Stock exchange

- Stock exchange are organized and regulated financial market where securities are traded at price governed by market forces of dd and ss.
- Exchanges are governed by capital market regulators.
- The exchange imposes rules listing requirements & statutory requirements that are binding on all listed and trading parties to make the trades more efficient and less risky.
- Stock exchange facilitates liquidity, mitigates counter-party risk & provides transparency in pricing.

Over-the-counter exchange

- OTC or off the exchange transaction in securities is done directly between 2 parties without the supervision of an exchange.
- In OTC trade price is not necessarily disclosed to the public.
- OTC market can lead to significant counterparty risk.
- It is the risk that a counterparty in a transaction will default prior to the expiration of the trade & will not make the payment required by the contract.
- These trades are less costly to execute & often both parties are fairly large and to each other.
- Stocks that trade via OTC are typically smaller companies that cannot meet the exchange listing requirements of formal exchanges. However, many other types of securities also trade here. Stocks that trade on exchanges are called listed stocks, whereas stocks that trade via OTC are called unlisted stocks.

Government securities market

- It is also called s Gilt-edged securities market.
- The term gilt-edged means “of the best quality”
- This is because the govt securities are free from risk of default and are highly liquid.
- This market deals with the securities such as bonds & other securities issued by central govt & state govt.
- The securities are issued in the form of bonds & credit notes.
- The buyers of such securities are banks, insurance companies, provident funds, RBI, and even individuals.

- The securities normally carry a rate of interest called the coupon rate.
- It is issued with different maturity dates.

Long-term loans market

- Banks and FIs provide long-term loans to firms.
- The long-term loans can be utilized for fixed assets, especially at the time of expansion & modernization.
- The maturity period of long-term loans is more than 1 year.

It is divided into three groups:

- **Term loan market** - banks & FIs like state financial corporation, SIDBI, EXIM bank provide term loans. The maturity period of term loans is one year or more.
- **Mortgages market** - it provides loans against security of immovable assets like land & building. The transfer of an interest in a specific immovable property to the lender of loan is called a mortgage.
- **Financial guarantees market** - apart from loans, financial institutions &banks provides financial guarantees on behalf of their client to third parties.

Eg a bank or FIs can provide a performance guarantee on behalf of its client to a third party. If the client does not perform the contract properly, the third party may impose a penalty. If the client fails to pay a penalty, the bank / FI issuing guarantee is held liable by third-party

Derivative Market

- The derivatives market refers to the financial market for financial instruments such as futures contracts or options that are based on the values of their underlying assets.
- A derivative is a financial instrument whose price is dependent upon or derived from one or more underlying assets.
- The most common underlying assets include stocks, bonds, commodities, currencies, market indexes.

- There are four kinds of participants in a derivatives market: hedgers, speculators, arbitrageurs, and margin traders.
- There are four major types of derivative contracts: options, futures, forwards, and swaps.
- There are 2 groups of derivative contracts: the privately traded OTC derivatives & exchange-traded derivatives (ETD) that are traded through specialized derivatives exchanges or other exchanges.
- The derivative market was introduced in India in 2000 & since then the derivative market is gaining great significance.
- Just like shares, derivatives are also traded on the stock exchange.
- Derivatives are the type of security, whose value is derived from underlying assets.
- These underlying assets can be stocks, bonds, commodities, or currency.
- Derivatives can either be exchange-traded or traded over the counter (OTC).
- Exchange refers to the formally established stock exchange wherein securities are traded and have a defined set of rules for the participants.
- Whereas OTC is a dealer-oriented market of securities, which is an unorganized market where trading happens by way of phone, emails, etc.
- Derivatives traded on the exchange are standardized and regulated.
- On the other hand, OTC derivative constitutes a greater proportion of derivatives contracts, but it carries higher counterpart risk and is unregulated.
- These financial instruments help in making a profit by simply betting on the future value of the underlying asset.
- Hence the name derivative as they derive the value from the underlying asset.

Characteristics of Derivatives

- Value-driven - It derive their value from a certain underlying asset such as stocks, bonds, commodities. Etc.
- Trading – derivatives are traded both in the exchange & OTC market.
- Future delivery – derivatives are contacted for future delivery of assets at the price agreed at the time of the contract. The quantity & quality of the asset is specified in the contract. The buyer of the asset will make the cash payment at the time of delivery.
- Hedge against risk – derivatives were introduced with the aim of minimizing the risk.

- High returns – derivatives were developed primarily to manage offset or hedge against risk but now they are developed primarily to provide the potential for high returns.

Participants of Derivative market

Hedger

Hedging is when a person invests in financial markets to reduce the risk of price volatility in exchange markets, i.e., eliminate the risk of future price movements.

Eg hedging involves a wheat farmer & the wheat futures market. The farmer plants seeds in the springs & sells his harvest in the fall. In the intervening month, the farmer is subject to the price risk that wheat will be lower price.

So when he plants his wheat he sells his harvest at a certain price. That is known as a forwarding hedge. Suppose if the price falls down then the farmer will be at profit

Speculator

These are individuals who take a view on the future direction of the markets.

They take a view whether the price would rise or fall in future and accordingly buy or sell future & option to try & make a profit from the future. The price movement of the underlying asset.

Eg you have bought the shares of a company X that deals with autos.

Due to the cyclical nature of the auto industry, the shares of this company might decline if the economy deteriorates.

In order to protect this investment, you might choose to buy a defensive stock like necessities eg toothpaste.

At times of economic clumps, these stocks will increase in there which can set the loss you might incur due to the loss of value of X company's stocks

Arbitrageurs

Arbitrage refers to simultaneous price & sale In two markets so that the selling price is higher than the buying price by more than the transaction cost, resulting in a riskless profit to the arbitrageur.

Suppose the cash market price is Rs 1000 per share of ABC ltd it may be quoted at 1010 Rs in the future market. An arbitrageur would purchase 1000 shares of ABC Ltd at Rs 1000 in the cash market & sell 1000 shares at RS 1010 in the future market.

Margin trader

Margin traders are speculators who make use of the payment mechanism, which is peculiar to derivative markets when a person trades in derivative products he is not required to pay the total value of the transaction.

Let us understand the margin trading derivatives with an example. For example, one lot of Bank of India comprises 3000 shares. If you buy 3000 shares of Bank of India at Rs 130, the cost works out to Rs 39,0000. But, in margin trading in the derivatives segment, you need to pay only margins and not the entire amount of Rs 390,000. At the moment, the margin fixed for the Bank of India is just 13 percent. So, you may end up paying just Rs 52,000 in place of Rs 390,000.

Types of derivative instruments

Forward contract

- Forwards are the oldest of all the derivatives.
- A forward is a contract between 2 parties wherein each agrees to exchange goods or instruments at a set price on a future date.
- The promised asset may be a currency, commodity, instruments like shares, debentures, etc
- It is an OTC agreement and has no standardized market features & is not legally binding.

Futures contracts

- A futures contract is a contract for the future.
- It is similar to a forwarding contract, except that it is a standardized one, which fixes the terms of the exchange that will take place between them at some fixed future date.
- An instrument /commodity is agreed to be bought or sold at a certain date in the future.
- The pre-set price is called the futures price.
- A futures contract is a legally binding agreement.
- Futures are traded on an organized exchange.

Options

- In an option, the seller has the obligation to either buy or sell to the buyer at a specified price by a specified date.
- Meanwhile, the buyer of an option contract has the right, but not the obligation to complete the transaction by a specified date.
- A call option gives the holder of the option the right, but not the obligation, to purchase at a specified price on the option's expiration date.
- Similarly, a put option gives the holder of the option the right, but not the obligation to sell at a specified price on the option's expiration date.

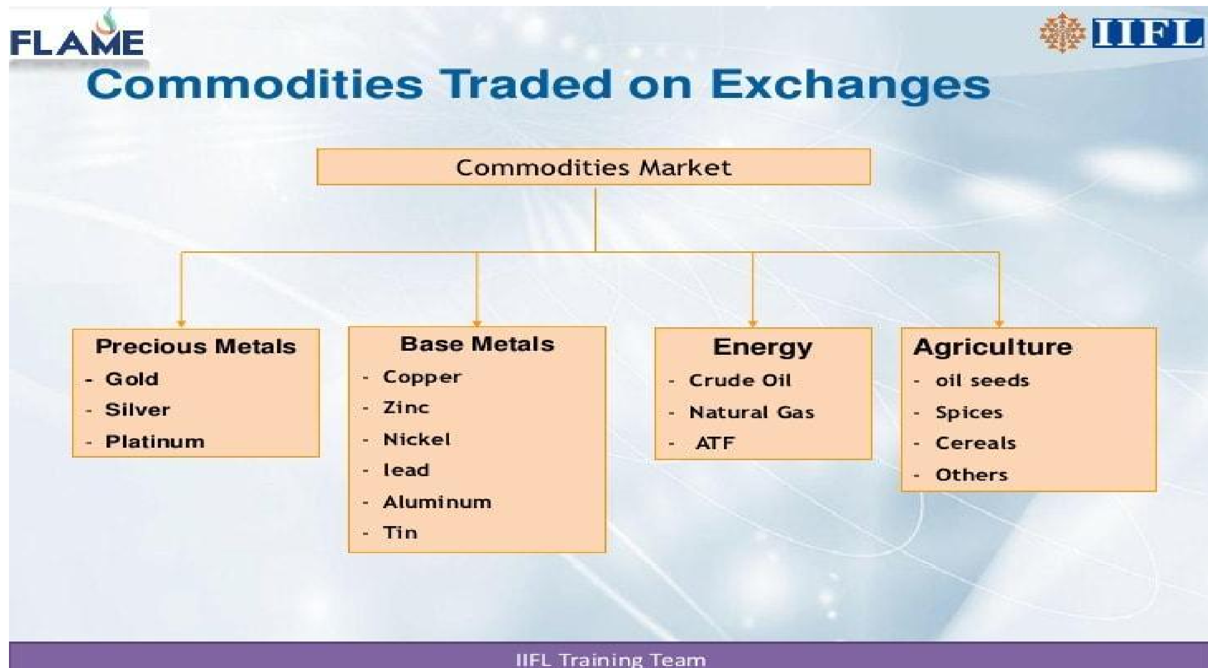
Swaps

- A swap is a derivative in which counterparties exchange cash flow of one party's financial instruments for those of the other party.
- Specifically, two counterparties agree to exchange one stream of cash flow against another stream.

Commodity market

- A commodity market is a market that trades in the primary economic sector rather than manufactured products.
- It is a market that provides a platform for trading primary products (raw materials).
- Trading in commodity markets includes physical trading & derivative trading using, forward, future, & options futures.
- Commodity markets are the oldest markets in the Indian Economic system.

- Soft commodities are agricultural products such as wheat, coffee, cocoa, fruits, sugar.
- Hard commodities are mined such as gold & crude oil etc.



Types of commodities traded in India

- You can classify the commodities into two types- Hard and Soft. Hard commodities are those that have to be extracted from the Earth. These include metals and minerals, such as gold, silver, copper, etc. Even crude oil is considered a hard commodity.
- Soft commodities are essentially food grains, edible oil, meat, and livestock.
- The types of commodities traded in India are gold, silver, Palmolein, castor seed, crude palm oil, menthan oil, rubber, cardamom, black pepper, etc. You can also trade in cereals, fibers, energy and gas, oilseeds, and other metals in India.
- The commodity market has become an alternative investment class over the world.
- Now investors can trade in India in selected commodities, electronically.
- These commodities are traded on the regulated commodity exchange.
- There are 22 commodity exchanges in India today.

India has 4 main national commodity exchanges -

- Multi Commodity Exchange (MDX),
- National Commodity & Derivative Exchanges(NCDEX),
- National Multi Commodity Exchange (NMCE)
- Indian Commodity exchange (ICEX)
- The regulatory is Forward Market Commission (FMC) which was set up in 1953 under the Ministry of Consumer Affairs.
- On 28 September 2015, it merged with SEBI to make the regulation of the commodity futures market strong.

The other major exchanges are:
- UCX (Universal Commodity Exchanges ltd. Mumbai)
- NBOT (National Board of Trade, Indore)
- ACE (Ace Derivatives and Commodity Exchange Ltd. Ahmedabad)

Role and functions

A commodity exchange market provides a platform through which commodities are traded. Besides being a platform the markets also play important roles in price discovery and information dissemination.

The function is as follows:

Price discovery
- Commodity market assist in price discovery (through futures contracts).
- This enables producers/miners (suppliers of a commodity) to make better-informed decisions regarding production quantum.
- Eg if the price indicates by the futures contracts trading present a bleak outlook on prices, producers who can hold production may decide not to produce and thus limits losses, or conversely a higher future price as a result of demand upticks can help producers meet more demand at a better price.
- Either way, this helps stabilize market fluctuations.

Hedging of counterparty & commodity price risks
- Commodity markets help to reduce the risk involved in commodity trade.
- Risks reduce because price and delivery times are pre-set with exchanges as the counterparty.

- Also, commodity derivatives further enhance this protection through futures pricing & settlement.
- Futures enable producers to lock in on pricing & delivery quantities thereby enabling them to make better production decisions.
- This especially helps in agriculture given the uncertainty regarding the monsoon and hence prices.
- This holds true also for products like metals/ energy commodities.

Fungible

- The very first characteristic of a commodity is that it is fungible; meaning that one unit of one kind of commodity could be exchanged with another unit of that same commodity without any loss of value.
- For instance, you should be able to exchange one barrel of oil with another barrel of oil without too much loss in value. If the product is not fungible, then it may not be a commodity.

Tradable

- It's also very important that the product is tradable. There are commodities that are directly listed on the exchanges and therefore they become tradable. For instance, look at the Brent crude. It is listed on an exchange so it is highly tradable.
- On the flip side, you can also check out the case of the plutonium commodity. This commodity is not listed on an exchange and that means it is not directly tradable.

Deliverable

- Because commodities should be tradable, they also need to be deliverable. The products food grains and oil can be delivered to whoever buys them if the buyer wants them. Thus, they are considered to be commodities.

Liquid

- The biggest characteristic that makes a commodity is a liquidity, which means that a huge number of people are buying in and out of the commodities at any given point in time. That means there is always an active market for these commodities and that the prices are always being quoted.
- Liquidity tells you that anyone can buy any amount of these commodities at very short notice, also ensuring the presence of an active secondary market.

Main players in commodity markets

Speculators

- When a person buys or sells the commodity by just predicting the market movement in the future, he becomes the speculator. The price may or may not go up.
- These traders earn by predicting the direction of movement in the market.

- Based on their estimations, they sign future contracts. These speculators do not desire any physical possession or long-term gains.
- They enter the market for short-term profits and exit as soon as their motive gets fulfilled. Their profits or losses depend directly on their market estimations.
- If they are able to predict the right spot prices, they can earn huge profits.

Hedgers

- These include the traders who wish to get physical possession of the commodities.
- Their main aim for entering into futures contracts is to save themselves from market volatility and inflation effects.
- They enter into contracts for the delivery of goods at a later date, at a price agreed upon today.

Arbitragers

- Arbitraging is primarily done in 2 different ways to make a profit from the futures market. Purchase and sell goods in 2 different markets so that the selling price is higher than the buying price by more than the transaction cost, thus enabling a person to make risk-less profits.
  Or
- Purchase & sale in the spot market & sale and purchase in the future market, so that selling price is higher than the buying price more than the transaction cost & interest cost, again resulting in a riskless profit.

Structure of commodity market

The commodities market exists in two distinct forms:

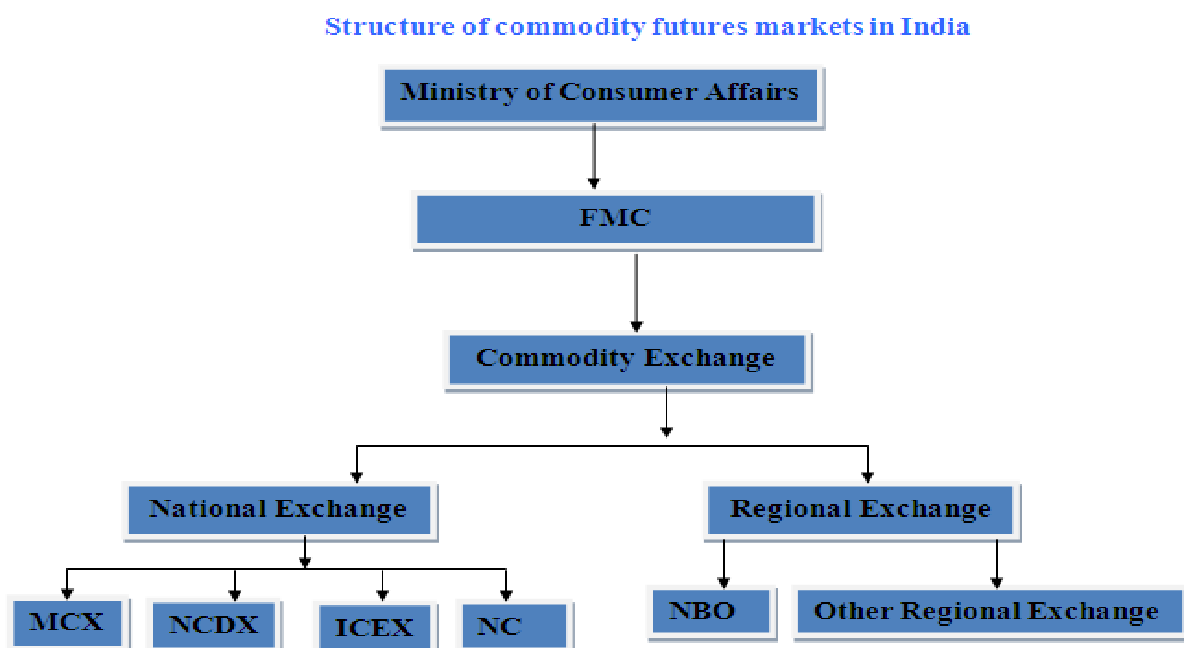
- over-the-counter (OTC) market
- exchange-based market

Similar to equities, there exists the spot and the derivatives segments. Spot markets are essentially OTC markets and participation is restricted to people who are involved with that commodity, such as the farmer, processor, wholesaler, etc.

A majority of the derivatives trading takes place through the exchange-based markets with standardized contracts, settlements, etc. The exchange-based markets are essentially derivative markets and are similar to equity derivatives in their work, that is, everything

is standardized and a person can purchase a contract by paying only a percentage of the contract value.

A person can also go short on these exchanges. Moreover, even though there is a provision for delivery, most contracts are squared-off before expiry and are settled in cash. As a result, one can see active participation by people who are not associated with the commodity. The typical structure of commodity futures markets in India is as follows:



Ministry of Consumer Affairs, Food, and Public Distribution

The Department pertaining to consumer affairs are responsible for the formulation of policies for:

- Monitoring Prices
- Consumer Movement in the country
- Controlling of statutory bodies (Bureau of Indian Standards (BIS) and Weights and Measures)
- Internal Trade
- Inter-State Trade- The Spirituous Preparations (Inter-State Trade and Commerce) Control Act, 1955 (39 of 1955).
- Control of Futures Trading- the Forward Contracts (Regulations) Act, 1952 (74 of 1952)

Forward Market Commission

The Commission functions under the control of the Ministry of Consumer Affairs, Food & Public Distribution, Department of Consumer Affairs, Government of India. The functions of the Forward Markets Commission are:

To advise the Central Government in respect of the recognition or the withdrawal of recognition from any association or in respect of any other matter arising out of the administration of the Forward Contracts (Regulation) Act 1952.

To keep forward markets under observation and to take such action in relation to them, as it may consider necessary, in the exercise of the powers assigned to it by or under the Act.

To collect and whenever the Commission thinks it necessary, to publish information regarding the trading conditions in respect of goods to which any of the provisions of the Act is made applicable, including information regarding supply, demand, and prices, and to submit to the Central Government, periodical reports on the working of forward markets relating to such goods.

To make recommendations generally with a view to improving the organization and working of forward markets.

To undertake the inspection of the accounts and other documents of any recognized association or registered association or any member of such association whenever it considers it necessary.

Advantages of Commodity Market

Protection against inflation

- As the demand for goods and services rise, it leads to an increase in the price of the goods and services as the cost of the raw materials i.e. commodity increases.
- In such an inflationary environment, interest rates rise, which increases the cost of borrowing and subsequently, reduces the net income of the company. A decline in the income of the company also affects the profits shared with the shareholders.
- Therefore, during inflation, the prices of the stocks fall. In contrast, the prices of commodities required in the manufacturing of finished goods substantially rise due to the growing demand, ultimately resulting in the rising prices of the final goods.
- Hence, investors flee to commodity futures to protect their capital from the effects of inflation and maintain their value.

Hedge against risky geopolitical events

- Geopolitical events such as conflicts, riots, and wars disrupt the supply chain which leads to scarcity of resources, as it becomes difficult to procure and transport raw material to the factories where they are converted into finished goods.
- In such a case, the supply of the raw materials gets affected, which results in a mismatch of demand and supply, causing the prices of the commodities to rise exponentially.
- During such events, there is pessimism in the market causing the stock prices to fall drastically. Hence, investing in commodities can help stem losses in an investment portfolio.

Diversification

- Commodities have a negative or low correlation with stocks. Commodities are usually raw materials required to make the finished goods.

- Rising commodity prices increase the cost of production, which reduces the profits, leaving very little for shareholders and reducing the earnings per share. This ultimately leads to a decline in the prices of the stocks.
- Also, due to inflation, the present value of future cash flows paid by stocks declines because future cash will be able to buy lesser goods and services than they would buy today. The prices of the stocks drop to reflect this reduction in value.
- Hence, stocks do well when the rate of inflation is stable or slowing. However, commodities perform better when the rate of inflation is rising.
- E.g., If oil prices increase, the cost of owning a car also increases, which results in declining car sales.
- Therefore, the prices of auto stocks also fall. Similarly, when metal prices rise, the cost of building houses increases, thus reducing the demand for real estate, which reflects in the falling prices of real estate stocks.
- Hence, due to this negative correlation where an increase in the price of commodities drives the stock prices down, the losses incurred in stocks can be adjusted against the

Gains attained by commodity derivatives. Thus, adding commodities provides diversification to your portfolio.

Transparency

- Trades in commodities are now conducted on an electronic trading platform accessible to all market participants.
- The electronic trading platform helps in fair price discovery enabled by broad-scale participation without the intervention of the buyer and seller.
- The price determination is driven by supply and demand, eliminating the risk of any form of manipulation.

Disadvantages

- Highly volatile. Commodities are one the most volatile asset classes around. In one analysis, commodities are twice as volatile as stocks and nearly four times as volatile as bonds. This extreme volatility makes commodities risky for certain investors.
- No income generation. Unlike other asset classes, commodities don’t generate any income for the investor.

Foreign Exchange Market

- Foreign exchange market is also called as currency Market or FOREX market.
- The currency market is the market in which foreign currencies are bought and sold.
- The buyers & sellers include individuals, firms foreign exchange, brokers, commercial banks & central banks.
- The transaction in this market is not confined to only one or a few foreign currencies.
- There are a large number of foreign currencies that are traded, converted & exchanged in the foreign exchange market.
- The foreign exchange market is not limited by any geographical boundaries.
- It does not have any regular market timings & operates 24hours 7days week, 365days a year.
- The foreign currency market never closes.
- Eg when the currency markets open in Europe, its counterpart in Asia will be winding down to a close. As the European market closes, the American market becomes active & as the American market closes, the Japanese market begins.
- This trading cycle continues throughout the day making the forex market the largest & most active market in the world.

Foreign Exchange Markets Role & Functions

- Currencies are bought and sold with prices determined by supply and demand with occasional government intervention.
- Currency transfers are accomplished by checks and bank drafts, bills of exchange, and mail and wire transfers.
- The players in the market are banks, brokers, and businesses, with some individuals trading on their own accounts.
- The FOREX market supports world commerce by allowing the transfer of funds from one currency to another, providing credit to businesses in the import trade, and offering a hedge against possible exchange-rate fluctuations.

Transfer Function

- The most visible function fulfilled by the foreign exchange market is to facilitate the conversion of one currency to another.

- In doing so, the foreign exchange market is the mechanism that transfers purchasing power from one country to another.
- When an importer in the United States imports goods manufactured in Germany, for example, the exporter wishes to be paid in euros.
- The conversion of U.S. dollars to euros is done through the foreign exchange market.
- Likewise, if an American businessman plans a trip to India, he exchanges U.S. dollars for Indian rupees through the foreign exchange market.

Credit Function

- By using the FOREX market, importers can obtain credit to finance their foreign purchases.
- Suppose an American company wishes to purchase an inventory of Chinese-manufactured tools.
- The American importer can pay for the purchase by using a bill of exchange in the FOREX market -- essentially an IOU with a three-month maturity.
- This instrument locks in the exchange rate and allows the importer 90 days to sell his products.
- A credit period of around that much time becomes essential for the smooth functioning of international trade.

Hedging function

- Exchange rates of currencies can fluctuate sharply resulting in uncertain payment terms & unnecessary gains/losses in trade.
- Importers & Exporters do not want to be burdened with the extra trouble of having to bear currency profits and losses.
- Hence futures in currency are used to hedge the currency exposure and protect the interest of both parties, against unexpected changes in the exchange rate.
- Accordingly, foreign exchange markets help minimize foreign exchange risk

Structure, classification & Participation

The foreign exchange market consists of two basic segments :

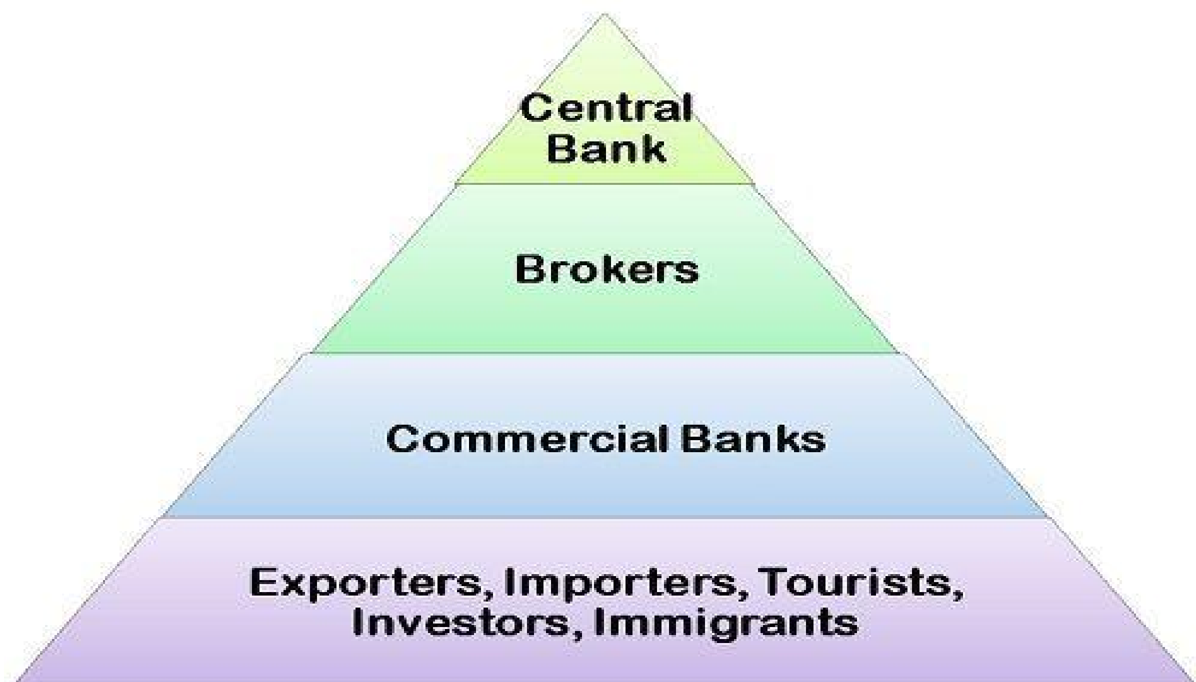
- Interbank or wholesale market &

- The clients or Retail Market.

Interbank Transactions are large transactions & in contrast, the retail segment is for smaller specific amounts.

- The wholesale Forex Market is dominated by large banks.
- In this market, large financial institutions transact with each other.
- The major portion of this trading is proprietary in nature (for the bank's own use)
- Bank also undertakes to trade on the customer's behalf, but this is a small portion.
- The central bank also participates in these segments.
- Other participants include – NBFCs, Authorised dealers, large MNCs, etc.
- Retail Forex Market – consists of individuals (tourists, foreign students, patients traveling abroad & so on) small companies, small exporters & importers.
- Money transfer companies are also major players in the retail market.

Participants in currency market



- Government & central Banks.
- They are probably the most influential participants involved in the forex market.
- Central banks as keepers of foreign exchange reserves are often instrumental(active) in maintaining reserve volumes & stable exchange rates to meet certain development goals. As central banks have very deep pockets, they can have a significant impact on the forex market.
- The central bank is the apex body in the foreign exchange market which has the power to regulate operations related to the trading of foreign currency. It directly intervenes in the functioning of the forex market to avoid aggressive fluctuations. For controlling fluctuations, the currency is sold off when it is overvalued and purchased in case it is undervalued. Central banks ensure that an exchange rate is at optimum that fulfills the needs of the national economy.

Forex brokers:

- Brokers in the foreign exchange market work as an intermediary between the commercial bank and central bank and also in between the commercial banks and buyers. These persons carry a large source of information about the market. Brokers only facilitate the currency trade but do not get themselves involved in market transactions. They work on a commission basis and do the task of striking the deal in-between the seller and buyer.

Commercial banks:

Commercial banks are important organs of the foreign exchange markets which are termed as “market makers”. These banks trade in foreign currencies for themselves and also for their clients. Commercial banks quoted the foreign exchange rate on a daily basis for purchasing and selling of foreign currencies. They act as a clearinghouse by facilitating the carrying off of differences between the demand and supply of these currencies. Currencies are purchased from brokers by commercial banks for selling them to buyers.

Buyers And Sellers:

These are real buyers and sellers of foreign currencies who trade in the foreign exchange markets with the help of brokers. They approach commercial banks for purchasing and selling off currencies. Importers, exporters, tourists, immigrants, and investors are some of these people.

MNCs:

MNCs are the major non-bank participants in the forward market as they exchange cash flows associated with their multinational operations. MNCs often contract to either pay or receive fixed amounts in foreign currencies at future dates, so they are exposed to foreign currency risk. This is why they often hedge these future cash flows through the inter-bank forward exchange market.

Individuals and Small Businesses:

Individuals and small businesses also use the foreign exchange markets to facilitate the execution of commercial or investment transactions. The foreign needs of these players are usually small and account for only a fraction of all foreign exchange transactions. Even then they are very important participants in the market. Some of these participants use the market to hedge foreign exchange risk.

Financial Regulators

Introduction

The most crucial part of the financial system is financial regulators.

Financial regulators supervise, control & develop financial stability with an aim to develop fair & efficient markets, improve financial stability and accelerate economic development.

The Indian financial system is regulated by independent regulators.

However, the Government also plays a significant role in controlling/ monitoring the financial system & has oversight responsibility on the financial system regulators

What are Financial Regulators?

A financial regulator is a constituent of the financial system.

Financial regulators supervise, monitor & regulate various constituents of the system.

Their objective is to develop a fair & efficient market & ensure financial stability, market confidence – to maintain confidence in the financial system, financial stability – contributing to the protection and, enhancement of stability of the financial system consumer protection – securing the appropriate degree of protection for consumers.

The main responsibilities of financial regulators include:

- Making & enforcing regulations.
- Preventing malpractices, manipulations & punishing misconduct.
- Monitoring & protecting various constituents of the system.
- Ensuring the competence of constituents

The Central & State Government passes various laws to bring regulators into existence.

Through these Acts & powers conferred by the Govt, the regulators then put in place a number of agencies/ commissions/departments to regulate and oversee financial system constituents markets & companies.

Eg: The Securities and Exchange Board of India (SEBI) is the regulator for the securities

market in India.

The operating area/scope of each of these regulators is governed by the laws of the land.

Accordingly, each regulator/agency has specific responsibilities and power that enable them to act independently.

Role of Regulators

A stable & efficient financial system has a potential & powerful influence on the country's economic development because it may have an impact on the level of capital formation, efficiency in the allocation of capital and also creates the confidence that end-users have in the integrity of the financial system.

The stability & efficiency of the system has both supply-side & demand-side effects on the economy.

In turn, a well-structured regulatory contributes to the efficiency & stability of the financial system.

Moreover, financial instability can be disastrous to the system & can push economic systems backward. As result, financial regulators have to play a key role in preventing the ill effects of financial instability.

Thus it becomes a need for every country to have a stabilized regulatory environment.

Following are some roles & functions of Regulators:

Laying down rules & guidelines

- Financial regulators lay rules & guidelines to ensure orderly functioning & healthy growth of the financial system.
- Financial system constituents have to adhere to those rules.
- Eg: Companies that desire to raise equity funds from the capital market have to adhere to the ICDR (Issue of Capital & Disclosure Requirement) guideline laid down by SEBI.

- Banks have to follow related norms by the RBI etc.

Monitoring & evaluation of the financial system & its constituents.

- Every financial system regulator also monitors various financial sector constituents.
- Regulators also evaluate the functioning of the constituents through periodical audits.
- Eg: SEBI & RBI ask for periodic returns or disclosure from banks & capital market entities & carry our regular off-site & on-site monitoring of entities they regulate.

Proactively manage financial crises

- A regulator proactively & comprehensively manages a financial crisis.
- A regulator regulates the entire constituents with help of related frameworks to smoothen effects in a crisis.

Restoring market confidence

- Regulators also maintain confidence in the financial system through their market outreach mechanisms.

Reduction in financial Crime

- A direct function of regulators is to reduce the occurrence of financial crimes through prudent regulation, regular oversight & continuous monitoring.
- This goes a long way in ensuring financial stability & economic growth.
- Developing an effective legal & regulatory framework for any financial system is a complex & iterative process.

One needs to bear in mind the following:

- The current stage of financial sector development in the economy.
- The kind of economic system that exists.
- The existing regulatory structure.
- Interdependence among various constituents of the financial system

Investors protection

- The most important role of regulators is to protect the investor against any fraudulent practices.
- one of the key aspects of investors protection is information.

- Regulators must provide accurate information relating to the risks & rewards of their investment & protect their interests.
- It is the task of the regulators to set minimum standards for market participants in order to achieve a level of investors protection.
- The market intermediaries should be able to refer to rules of business conduct that ensure that investors will be treated in a just & equitable manner.

Ensuring that the market is fair, efficient & transparent

- The law, regulation & rules which ensure that the investors are protected also tend to ensure that the market is fair.
- However, investors' information is also a substantial part of the fairness & transparency of the market.
- The degree & speed that information is transmitted & propagated through the market defines the transparency of the market.

Reduction of risk

- No amount of regulation can guarantee against the possibility of the financial failure of a market intermediary.
- However, regulation can & should aim to reduce the risk of failure.
- Effective management & appropriate checking of excessive risk-taking with the prudential requirements as to capital should be ensured in order to address the absorption of some losses.

Regulatory Framework for Financial instruments & Financial

- The securities market is regulated by various agencies such as the Department of Economic Affairs (DEA), the Department of Company Affairs (DCA), the Reserve Bank of India(RBI), and SEBI.
- The activities of these agencies are coordinated by a high-level committee on the capital and financial market.
- The High-Level Coordination Committee for Financial Market (HLCCFM) discusses various policy level issues which require inter-regulatory coordination between the regulators in the Financial market, viz., RBI, SEBI, Insurance Regulatory &

Development Authority (IRDA), and Pension Fund Regulatory and Development Authority (PFRDA).

- The committee is chaired by the Governor, RBI, Secretary – Ministry of Finance, Chairman – SEBI, Chairman – PFRDA are members of committee.
- The two major regulatory & Promotional institutions in India are the Reserve Bank Of India(RBI) & the Securities Exchange Board of India (SEBI).
- Both RBI & SEBI administer, legislate, supervise, monitor, control & discipline the entire Financial System.
- RBI is the apex of all financial institutions in India.
- All financial institutions are under the control of RBI.
- The financial market is under the control of SEBI.

RESERVE BANK OF INDIA

- The RBI was established by legislation in 1934 through the Reserve Bank Of India Act 1934.
- It started functioning on April 1, 1935.
- Its central office is in Mumbai since 1937.
- Though originally privately owned, since nationalization in 1949, it is fully owned by the Government of India. Thus RBI was established as per act 1934 & empowerment took place in Banking Regulation Act 1949.
- The RBI is the Central Bank of our country.
- The preamble prescribes the objectives as
  i) to secure monetary stability within the country.
  ii) to operate the currency and credit system to the advantage of the country.
- In other words, the objective of the RBI is price stability & ensuring adequate credit availability to finance economic activities for the benefit of the country.
- It is the apex financial institution of the country's financial system entrusted with the task of control, supervision, promotion, development & planning.
- The RBI is the queen bee of the Indian financial system which influences commercial banks' management in many ways through its various policies, directions & regulations.
- The fundamental object of RBI is to discharge purely central banking functions in the Indian money market, I.e to act as the note-issuing authority, bankers' bank, and bankers to govt, & to promote the economic policy of the govt, consistent with the need of maintenance of price stability.

- The most significant provision of the Banking Regulation Act is the supervision & regulation of banks. Sec. 35 of the act says that RBI can inspect any branch of India Bank located in or outside the country.
- Further, it issued licensing for the banks & can establish new branches to maintain regional balance in the country.
- It also arranges the training colleges for the bank's employees & officers.:-
- Three training establishments, namely the College of Agricultural Banker Banking, the Banker's Training College, & the Reserve Bank Of India Staff College are part of RBI.
- Other such as the National Institute for Bank Management, Indira Gandhi Institute for Development Research (IGIDR) & the Institute for Development & Research in Banking Technology (IDRBT) is autonomous.
- The RBI is empowered to buy & sell government securities from public & financial institutions.
- The RBI is empowered to buy & sell govt securities, treasury bills & other approved securities.
- The money market comes within the direct purview of the RBI regulations.
- It influences liquidity & interest rate through a number of operating instruments such as CRR, Open Market Operation, Repos, Change in bank rates, etc.

Role &Functions of RBI

RBI was established on 1st April 1935 under the Reserve Bank of India Act, 1934. RBI was set up after the recommendations of the Hilton Young Commission which had submitted its report in the year 1926. Later on, in 1931 the Indian Central banking inquiry committee had also recommended the establishment of the central bank in India.

Initially, the Reserve Bank of India was established as a private shareholders bank, but it was nationalized after independence in the year 1949 through the Reserve Bank (Transfer of public ownership) act, 1948.

Functions of RBI:-

- Traditional / Monetary Functions
- Supervisory Functions
- Promotional Role

Traditional functions:

Traditional roles and functions of RBI refer to those functions which every Central Bank of a country has to perform all over the world. Traditional functions are mainly the basic and fundamental functions of RBI.

Issue currency notes:

RBI has the sole authority to issue currency notes in India. Earlier all currency notes except one rupee note and coins of the smaller denomination were issued by RBI. However, the Reserve Bank of India in the New Mahatma Gandhi series has issued notes in the denominations of Rs 10 and above. Reserve Bank of India has been given these exclusive powers under the provisions of section 22 of the Reserve Bank of India Act, 1934. This system of issuing currency notes is known as the minimum reserve system. The currency notes issued by RBI are legal tender throughout the territory of India without any limitations. It issues these currency notes against the security of gold bullion, gold coins, promissory notes, exchange bills and government of India bonds, etc.

Banker to other banks:

Reserve Bank of India is the apex monetary body in the country and it controls the volume of bank reserves. It helps and regulates other banks to create credit in the right proportion. It has obligatory powers to regulate, guide, help, and direct other banks of the country, and hence it acts as the guardian of commercial banks in India. Every commercial bank has to maintain a certain part of the Reserves with RBI. Reserve Bank of India acts as the lender of last resort and banks can approach RBI when they need funds. Under the Banking Regulation Act, 1949 RBI has extensive powers to supervise and control the banking system of the country.

Banker, agent, and financial advisor of the government:

Under section 20 of the Reserve Bank of India Act, it acts as the banker and agent to the government. Section 21 and 21A give powers to RBI to conduct transactions of Central and state governments. It has the duty to make payments, taxes, and deposits on behalf of the government. It represents the Government of India at International levels. It gives financial advice to the government and maintains government accounts. It has a responsibility to

manage public debt and maintain foreign exchange reserves. It provides overdraft facilities to Central and state governments.

Exchange rate management and the custodian of Foreign Exchange Reserves:

Reserve Bank of India has the responsibility to stabilize the external value of the Indian currency. It keeps gold bullions and foreign currency reserves etc. against currency note issues and has the responsibility to meet the adverse balance of payment with other nations. RBI has the responsibility to maintain exchange rate stability and for this, it has to bring demand and supply of foreign currency (usually US Dollar) to similar levels. It maintains this stability through buying and selling of foreign currency etc.

RBI as the bank of Central clearance, settlement, and transfer:

RBI provides the facility of a clearinghouse for settling banking transactions. This allows other banks to settle their interbank claims smoothly and economically. At places where RBI does not have its own office, this function is carried out on the premises of the State Bank of India. This facility is provided by the Reserve Bank of India through a cell called the National Clearing Cell.

Credit control function:

RBI tries to maintain price stability in the country which is essential for economic development. It regulates the money supply in the economy according to the changing circumstances of the economy. It uses various measures such as qualitative and quantitative techniques to regulate credit in the economy. It uses quantitative controls such as bank rate policy, cash reserve ratio, open market operations, etc. Qualitative controls include selective credit control, rationing of credit, etc.

Supervisory Role and Functions of RBI

RBI performs certain non-monetary functions for the supervision of banks and promotion of sound banking systems in India. Supervisory functions ensure improvement in the methods of

operation of Banking in India. It controls and administers the entire financial and banking system of India through these functions

Giving license to banks:

RBI has the authority to grant licenses to the banks for carrying out business. It provides licenses for the opening of new branches, opening extension counters, and also for closing down existing branches. Reserve Bank of India through this power avoids unnecessary competition among different banks at any particular location. It helps RBI to remove undesirable people from entering into the banking business.

Bank inspection and inquiry:

RBI has the power to inspect and enquire banks in various matters under the Banking Regulation Act, and the Reserve Bank of India act. It can inspect loans and advances, deposits, investment functions, etc. which helps to ensure that financial institutions and banks carry out their operations in a proper manner. It carries out periodical inspection once or twice a year and banks have to take remedial measures pointed out during an inspection. It also asks for periodical information regarding certain Assets and liabilities of banks.

Implementation of deposit Insurance Scheme:

RBI has the responsibility to implement the Deposit Insurance Scheme to ensure the protection of deposits of small depositors. Under this scheme, deposits below Rs 1 lakh are insured with the Deposit Insurance Guarantee Corporation set up by the Reserve Bank of India. It implements the Deposit Insurance Scheme in case of failure of any Bank. Deposits made in the accounts of commercial banks, cooperative banks, and RRBs are covered under this scheme. The fixed deposits with Institutions such as ICICI, IDBI, etc are not covered under this scheme.

Control over Non-Banking Financial Institutions:

The monetary policy of RBI does not influence the Non-Banking Financial Institutions. However, it gives directions to the Non-Banking Financial Institutions and also conducts inquiry and inspection to exercise control over these institutions. For example, it requires permission from the Reserve Bank of India for deposit-taking operations by Non-Banking Financial Institutions.

Periodic review of the working of commercial banks:

The supervisory functions of RBI also includes periodic review of the working of commercial banks. It takes necessary steps to increase the efficiency of the commercial banks, and for the implementation of policy changes and schemes for the improvement of the banking system.

Promotional and developmental Role and Functions of RBI

Every Central Bank has to perform numerous promotional and development functions which vary from country to country. This is truer in a developing country like India where RBI has been performing the functions of the promoter of the financial system along with several special functions and non-monetary functions.

Promotion of Banking habits and expansion of the banking system:

It performs several functions to promote banking habits among different sections of the society and promotes the territorial and functional expansion of the banking system. For this purpose, RBI has set several Institutions such as Deposit and Insurance Corporation 1962, the agricultural refinance Corporation in 1963, the IDBI in 1964, the UTI in 1964, the Investment Corporation of India in 1972, the NABARD in 1982, and national housing Bank in 1988, etc.

Export promotion through refinances facility:

RBI promotes export through the Export Credit and Guarantee Corporation (ECGC) and EXIM Bank. It provides refinance facility for export credit given by the scheduled commercial banks. The interest rate charged for this purpose is comparatively lower. ECGC

provides insurance on export receivables whereas EXIM banks provide long-term finance to project exporters etc.

Development of financial system:

RBI promotes and encourages the development of Financial Institutions, financial markets, and financial instruments which is necessary for the faster economic development of the country. It encourages all the banking and non-banking financial institutions to maintain a sound and healthy financial system.

Support for Industrial finance:

RBI supports industrial development and has taken several initiatives for its promotion. It has played an important role in the establishment of industrial finance institutions such as ICICI Limited, IDBI, SIDBI, etc. It supports small-scale industries by ensuring an increased credit supply. Reserve Bank of India directed the commercial banks to provide adequate financial and technical assistance through specialized Small Scale Industries (SSI) branches.

Support to the Cooperative sector:

RBI supports the Cooperative sector by extending indirect finance to the state cooperative banks. It routes this finance mostly via the NABARD.

Support for the agricultural sector:

RBI provides financial facilities to the agricultural sector through NABARD and regional rural banks. NABARD provides short-term and long-term credit facilities to the agricultural sector. RBI provides indirect financial assistance to NABARD by providing a large amount of money through the General Line of Credit at lower rates.

Training provision to banking staff:

RBI provides training to the staff of the banking industry by setting up bankers training colleges at many places. Institutes like the National Institute of Bank Management (NIBM),

Bank Staff College (BSC), etc. provide training to the Banking staff.

Data collection and publication of reports:

RBI collects data about interest rates, inflation, deflation, savings, investment, etc. which is very helpful for researchers and policymakers. It publishes data on different sectors of the economy through its Publication division. It publishes weekly reports, annual reports, reports on trends and progress of commercial banks,s, etc.

Prohibitory Role and Functions of RBI

1. RBI cannot purchase the shares of any industrial undertaking or even its own share.
2. It cannot provide direct monetary or financial assistance to any commercial undertaking or trade etc.
3. RBI does not have the power to buy any immovable property.
4. RBI does not have the authority to give loans on the security of property or shares.

Securities Exchange Board Of India (SEBI)

- The Securities Exchange Board of India (SEBI) was set up on 12th April 1988.
- The main purpose of setting up SEBI was to develop & regulate the stock market in India.
- With the announcement of the reforms package in 1991, the volume of business in both the primary & secondary segments of the capital market increased.
- A multicrore securities scam rocked the Indian Financial System in1992.
- Then existing regulatory framework was found to be inadequate & hence a need for an autonomous, statutory, & integrated organization to ensure the smooth functioning of the capital market was felt.
- To fulfill this need, the SEBI which was already in existence since April 1988, was conferred statutory powers to regulate the capital market & other related issues.
- So In January 1992, SEBI Act was passed. The act gave statutory power or recognition to SEBI under SEBI act 1992 which came into force on 30 January 1992.
- The SEBI is the regulator of the securities market in India.

- It was established to protect the interest of the investors & to promote the development of and regulation of the securities market. It regulates corporates in the issuance of capital & transfer of securities.
- SEBI also regulates all intermediaries and persons associated with the securities market.
- It monitors & evaluates the operations of securities market intermediaries & financial services through inspection, audits.
- It has the power to register, regulate & control various securities markets constituents.
- It was established in the year 1988 & was given statutory power on 12th April 1992, through the SEBI act 1992.
- The act was amended in the years 1995, 1999, 2002 to meet the requirement of changing needs of the securities market.
- SEBI has its headquarters at the business district of Bandra Kurla Complex in Mumbai and has Northern, Eastern, Southern, and Western Regional Offices in New Delhi, Kolkata, Chennai, and Ahmedabad respectively.
- It has opened local offices at Jaipur and Bangalore and has also opened offices at Guwahati, Bhubaneshwar, Patna, Kochi, and Chandigarh

Objective of SEBI

The main objectives of SEBI are:

- To protect the interest of investors.
- To bring professionalism in the working of intermediaries in the capital markets – brokers, mutual funds, stock exchanges, Demat depositories, etc.
- To create a good financial climate, so that companies can raise long-term funds through the issue of securities – shares & debentures.
- Monitors important acquisition of shares and takeover of companies.
- Protect the interest of investors.
- Promoting the development of the securities market and regulating the business.
- It is also involved in research & development so that the stock market is efficient and updated with advanced techniques.
- It offers a platform for sub-brokers, registrars, stockbrokers, portfolio managers, investment advisers, bankers, merchant bankers, share transfer agents, trustees of trust deeds, underwriters, and other associated people to register and regulate work.

- They also check that the investors are educated about the intermediaries of the securities market.
- They also keep a close check that no fraudulent or unfair practices are done related to the securities market.
- It also controls the operations of participants, credit rating agencies, and custodians of securities, depositories, and foreign portfolio investors.

Power of SEBI over Stock Exchanges

- To regulate and approve by-laws of stock exchanges.
- Inspect the books of accounts of recognized stock exchanges and call for periodical returns.
- Inspect the books of financial Intermediaries.
- Compel certain companies to get listed on one or more stock exchanges.
- To handle the registration of brokers.
- When it comes to stock exchanges, SEBI has the power to regulate and approve any laws related to functions in the stock exchanges.
- It has the powers to access the books of records and accounts for all the stock exchanges and it can arrange for periodical checks and returns into the workings of the stock exchanges.
- It can also conduct hearings and pass judgments if there are any malpractices detected on the stock exchanges.
- When it comes to the treatment of companies, it has the power to get companies listed and de-listed from any stock exchange in the country.
- It has the power to completely regulate all aspects of insider trading and announce penalties and expulsions if a company is caught doing something unethical.
- It can also make companies list their shares in more than one stock exchange if they see that it will be beneficial to investors.
- Coming to investor protection, SEBI has the power to draft legal rules to ensure the protection of the general public.
- It also has the power to regulate the registration of brokers and other middlemen who will deal with investors in the market.

Organizational Structure:

The SEBI Board consists of nine members-

1. One Chairman appointed by the Government of India.
2. Two members who are officers from Union Finance Ministry.
3. One member from the Reserve Bank of India.
4. Five members appointed by the Union Government of India.

Functions of SEBI

Protection of investors interest

- SEBI frames rules & regulations to protect the interest of investors.
- It monitors whether the concerned parties are following the rules & regulations i.e. issuing companies mutual funds, brokers & others.
- SEBI handles investors' complaints against brokers, companies issuing securities & agencies connected with issues or management of securities.
- SEBI has introduced investors Protection & Education Fund. The fund is utilized for the purpose of protection of investors & promotors of investors' education & awareness.

Regulates working of mutual funds

- SEBI regulates the working of mutual funds.
- For this purpose, SEBI has laid down rules & regulations that are to be followed by mutual funds.
- It has prescribed the SEBI (MUTUAL FUNDS) Regulation Act 1993.
- Necessary modifications are made in the regulations from time to time.
- The regulations are to be complied with by all mutual funds in India.
- SEBI may cancel the registration of mutual funds if it fails to comply with the regulations.

Prohibition on Insiders trading

- It has prohibited insider trading activity.
- SEBI regulation states that no insiders (connected with the company) shall either on his behalf or on any other person, deals in securities of a company listed on any stock exchange on the basis of any unpublished prices sensitive information.

Regulates merchant banking

- It has laid down regulations in respect of merchant banking activities in India.
- SEBI has laid down SEBI (Merchant Bankers) Regulation 1992 which is to be followed by all merchant bankers in India.
- The regulation is in respect of registration, code of conduct to be followed, submission of half-yearly result & so on.

Portfolio management

- It has also enacted regulations to regulate the working of portfolio managers. Portfolio managers make decisions for individuals & institutions.SEBI has laid down that no person or institution can operate as a portfolio manager without registration. They have to follow the relevant regulation.

Regulates stock brokers' activities

- It has laid down regulations in respect of brokers & sub-brokers. No brokers or sub-brokers can buy, sell or deal in securities without being a registered member of SEBI. Such registration enables SEBI to regulate stockbroker's activities.
- In August 2014, SEBI cleared a proposal for a one-time registration process for stockbrokers & clearing entities that would to operate across stock exchanges. Member would be required to have only one single certificate of registration issued by SEBI. It will prevent duplication of the registration process for each stock exchange

Research & publicity

- It conducts surveys in respect of investments & opportunities. SEBI brings out monthly bulletins covering articles relating to developments in securities market economic development & so on. Some news & publications include – press releases, SEBI bulletins, annual reports, public notices, working papers, speeches, etc.

Regulates takeover & mergers

- It has issued a set of guidelines to protect the interest of the investors in the case of taking over & mergers. Guidelines are to be followed by corporations. The SEBI (Substantial Acquisition & Takeover) Regulation, 1997 & its subsequent amendments aim at making the takeover process transparent & also protecting the interest of minority shareholders.

Monitoring of stock exchanges

- SEBI plays an important role in monitoring stock exchanges, in order to improve the working of stock markets in India. The role is stated below:
- Submission of Annual report.
- Submission of periodical returns.

Capital market reforms by SEBI

It has introduced reforms in the capital market to make it more effective.

In recent years it has introduced several capital market reforms in order to improve the performance of capital or the stock market.

Some of the important reforms are:

- Buyback of shares is allowed to reduce the chances of a hostile takeover.
- Introduction of corporate governance whereby BOD must govern the listed company properly in the interest of shareholders & other stakeholders.
- Demat of shares has been introduced to do away with the problems of the physical transfer of shares.
- For transparency in brokers transactions – rules have been introduced.
- PAN is made compulsory for investors to trade on stock exchanges.

Guideline on capital issues

It has framed necessary guidelines in connection with capital issues. The guidelines are applicable to:

- First public issue of new companies.
- First public issue by existing private companies.
- Public issue by existing listed companies.

Other functions:

- It prohibits fraudulent & unfair trade practices relating to the securities market.
- It promotes & regulates self-regulatory organizations.
- It promotes investors' education & also training of intermediaries in the securities market.
- It conducts inspections, inquiries & audits of stock exchanges & intermediaries & self – regulatory organizations in the securities market.

Evolution

SEBI is a 25 years old institution; however regulation of securities markets predates SEBI by many years. Hence it is necessary to understand regulation in securities markets before SEBI to appreciate the role that SEBI currently plays.

PRE – SEBI ERA.

Organized financial markets have been around in India since the 1800s (shares of banks used to trade in India in 1830. The 1850s saw the emergence of the companies act which led to the formation of the joint-stock company.

Security trading in India goes back to the 18th century when the East India Company began trading in loan securities. Corporate shares started being traded in the 1830s in Bombay (now Mumbai) with the stock of Bank and Cotton presses. The simple and informal beginnings of stock exchanges in India take one back to the 1850s when 22 stockbrokers began trading opposite the Town Hall of Bombay under a banyan tree. The tree still stands in the area which is now known as Horniman Circle.

The venue then shifted to banyan trees at the Meadows Street junction, which is now known as Mahatma Gandhi Road, a decade later. The shift continued taking place as the number of brokers increased, finally settling in 1874 at what is known as Dalal Street.

This as yet informal group known as the Native Share and Stockbrokers Association organized itself as the Bombay Stock Exchange (BSE) in 1875. The BSE is the oldest stock exchange in Asia and was the first to be granted permanent recognition under the Securities Contract Regulation Act, 1956.

The BSE was followed by the Ahmedabad Stock Exchange in 1894 which focused on

trading in shares of textile mills. The Calcutta Stock Exchange began operations in 1908 and began trading shares of plantations and jute mills. The Madras Stock Exchange followed, being set up in 1920.

India witnessed the first stock market crash way back in1856 when the shares prices fell drastically once the civil war ended. Interesting isn't it how a war in America actually caused the stock markets in Mumbai to crash.

The first regulation for stock exchanges was promulgated in 1925 through the Bombay Securities Contracts Control Act which was followed by the control of stock exchange & forward markets coming under the central govt on January 26, 1950. In 1956 the Securities Contract (Regulation)Act was formulated to provide for control over trading & Stock exchanges.

Prior to SEBI, the security market was regulated by several acts which were:

- The Bombay Securities Contract Control Act 1925
- The Capital Issues (Control) Act 1947
- The Securities Contract (Regulation) Act 1956
- Registrar of Companies (The Companies Act, 1956)

Controller of Capital Issues was the regulatory authority before SEBI came into existence it derived authority from the Capital Issues (Control) Act,1947.

SEBI Era

Given the large information, prevalent frauds & evolving financial markets architecture GoI decided to set up a separate board for the regulation & orderly functioning of stock exchanges. In July 1987, the cabinet committee on Economic Affairs approved the broad features of SEBI. With the announcement of economic reforms in the early 1990s, SEBI's role grew multifold as both volume & complexity of business in securities markets increased in both primary & secondary segments.

The early days of SEBI were rocked by the multi-crore securities scam which pointed out a gap in the existing regulatory framework. To overcome these shortcomings SEBI which was already in existence since April 1988 was conferred statutory power to regulate the capital market. SEBI was given additional power by GoI through an amendment to SEBI Act

1992. That ordinance conferred wide-ranging power on SEBI Certain powers under certain sections of the Securities Contract (Regulation) Act & Companies Act was delegated to the SEBI.

The regulatory power of SEBI was increased through the Securities Laws (Amendment) ordinance of January 1995 and subsequently replaced by an act of parliament.

Today, SEBI works under the ministry of finance and has been given a status of an independent organization regulating each & every aspect of the securities market backed by a statute. SEBI is also accountable to the parliament.

Regulations, guidelines & schemes issued by SEBI

SEBI regulate the securities market through rules under the Securities Contract (Regulation) Act (SCRA), the SEBI Act & Depositories Act. SEBI has framed regulation under the SEBI Act & Depositories Act for registration & regulation of all market intermediaries, for prevention of unfair trade practices, & insiders trading.

Under these acts, the govt & SEBI issues notification, Guidelines, & Circulars. The powers in respect of the contracts for sale & purchase of govt securities, money market securities & ready forward contracts are debt securities are exercised concurrently by the RBI.

SEBI ensures that market participants adhere to regulatory norms. The stock exchange act as a self-regulatory organization(SRO) & also regulates market & price as per the prevalent regulations. Accordingly, SEBI & the exchange play complementary roles enhance role to enhance investor protection & market transparency & quality

The four main legislations governing the capital market are as follows.:

- The SEBI Act 1992 establishes the SEBI with four-fold objectives of protection of the interest of the investors in securities, development of the securities market, regulation of the securities market, and matter connected therewith.
- The Companies Act 1956 deals with issue, allotment & transfer of securities, disclosures to be made in public issues, underwriting, rights & bonus issues & payment of interest & dividends
- The Securities Contract (Regulation) Act 1956 provides for the regulation of securities trading & the management of stock exchanges.

- The Depositories Act, 1996 provides for the establishment of depositories for electronic maintenance & transfer of ownership of Demat securities.
- There are various other regulations, guidelines & schemes issued by SEBI. The regulations are frequently reviewed & amendments notify. Regulations are superior to guidelines as the former have a stronger legal force. Regulations are passed by the SEBI.

Dispute & settlement

- The order of the SEBI under the securities laws is appealable before a security appellate tribunal (SAT) the body that hears appeals against the SEBI's order.
- The order of the SAT is appealable before the high court or the supreme court.
- Under SEBI guidelines, the proposal to settle a dispute is first placed before a high-powered advisory committee of the regulator.
- If the proposal gets the committee's approval, the terms of the settlement are drafted & orders are passed by a panel of two whole-time directors of SEBI after the cause and nature of the violation are established.

Process of regulations

- SEBI supervises through on-site & off-site inspection, enforcement & inquiry against violation of rules and regulation, & prosecution in order to effectively discharge its regulatory function, the SEBI has put I place an Integrated Market Surveillance System (IMSS) which generates alerts arising out of unusual market movements.
- This system helps in analyzing, detecting, identifying & taking preventive actions in a number of cases where the abnormal trading pattern is observed.
- This in turn ensures market integrity, promotes professional standards of participants & their orderly conduct which is vital for the smooth functioning of the securities market.
- Self-regulatory by participants is preferred & setting up of SROs is promoted.
- SRO is the first level capital market regulator which is a non-government body having statutory responsibility to regulate its own members for fair & efficient practices.
- SROs are expected to share the responsibility with the regulator in framing & administering regulation. The Association of Merchant Bankers of India, the Association of Mutual Funds of India, the Indian Banks Association & the Association of NSE is designated SROs.

Insurance Regulatory and Development Authority (IRDA)

Many of you might have heard the term "IRDA". It is nothing but the abbreviation of the Insurance Regulatory and Development Authority. The Authority acts as the regulator of the insurance industry in India and oversees the functioning of the Life Insurance and General Insurance companies operating in the country. The main objective of the IRDA is to protect the interests of the policyholder and regulate the insurance industry.

What is the Insurance Regulatory and Development Authority (IRDA)?

The Insurance Regulatory and Development Authority is the main organization or supervisory body that regulates the insurance sector in the country. It sets rules and regulations for the functioning of the insurance industry. Its sole purpose is to protect the interest of policyholders and to develop the industry on the whole.

The IRDA or IRDAI regularly issues advisories to insurance companies in case of changes to the rules and regulations. The regulator guides the insurance industry in promoting efficiency in the conduct of the insurance business all the while controlling the rates and other charges related to insurance.

Insurance Regulatory and Development Authority of India or the IRDAI

The Insurance Regulatory and Development Authority of India or the IRDAI is the apex body responsible for regulating and developing the insurance industry in India. It is an autonomous body. It was established by an act of Parliament known as the Insurance Regulatory and Development Authority Act, 1999. Hence, it is a statutory body.

The IRDAI is headquartered in Hyderabad in Telangana. Prior to 2001, it was headquartered in New Delhi.

Establishment of IRDA:

The Government of India was the regulator for the insurance industry until 2000. However, to institute a stand-alone apex body, the IRDA was established in 2000 following the

recommendation of the Malhotra Committee report in 1999. In August 2000, the IRDA began accepting applications for registrations through invites and allowed companies from other countries to invest up to 26% in the market.

The IRDA has outlined several rules and regulations under Section 114A of the Insurance Act, 1938. Regulations range from registration of insurance companies for operating in the country to protecting policyholders' interests. As of September 2020, there are 31 General Insurance companies and 24 Life Insurance companies who are registered with the IRDA.

Parliament on 22 March 2021, passed the Insurance Amendment Bill 2021 to increase the FDI limit in the Insurance sectors to 74% from 49%

IRDA MISSION

Structure:

- The authority comprises of 10 member team.
- A chairman & 5 full-time members who hold office for a term of 5years &shall be eligible for reappointment.
- 4 part-time members who hold office for a term not exceeding 5 years from that date on which he enters upon his offices.
- All the above-mentioned members are appointed by the GOI.

Functions:

The functions of the IRDAI are defined in Section 14 of the IRDAI Act, 1999,[1] and include:

- Issuing, renewing, modifying, withdrawing, suspending, or canceling registrations.
- Protecting policyholder interests.
- Specifying qualifications, the code of conduct, and training for intermediaries and agents.
- Specifying the code of conduct for surveyors and loss assessors.
- Promoting efficiency in the conduct of insurance businesses.
- Promoting and regulating professional organizations connected with the insurance and reinsurance industry.
- Leaving fees and other charges.

- Inspecting and investigating insurers, intermediaries, and other relevant organizations.
- Regulating rates, advantages, terms, and conditions which may be offered by insurers not covered by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938).
- Specifying how books should be kept.
- Regulating company investment of funds.
- Regulating a margin of solvency.
- Adjudicating disputes between insurers and intermediaries or insurance intermediaries.
- Supervising the Tariff Advisory Committee.
- Specifying the percentage of premium income to finance schemes for promoting and regulating professional organizations.
- Specifying the percentage of life- and general insurance business undertaken in the rural or social sector.
- Specifying the form and the manner in which books of accounts shall be maintained, and statement of accounts shall be rendered by insurers and other insurer intermediaries.

Evolution

- Pre IRDA.
- The Indian Life Assurance Companies Act, of 1912 was the first statutory measure to regulate life business. In 1938, with a view to protecting the interest of the Insurance public, the Insurance Act, 1938 was enacted with comprehensive provisions for effective control over the activities of insurers.
- In the 1950s there were many insurance companies & there were many allegations of unfair trade practices. GOI, therefore, decided to consolidate the insurance business & consequently nationalize it. On 19th January 1956, the life insurance sector was nationalized & life insurance corporations came into existence.
- LIC absorbed 245 Indian & foreign insurers & continued as a monopoly Insurance provider till the late 90’s when the insurance sector was liberalized.

Timeline of IRDA’s Evolution

- In 1991 – govt of India begins the economic & financial sector reform program.

- In 1993- the committee on reform in the Insurance sector, headed by Mr. R.N. Malhotra (retired governor, RBI of India) set up to recommend reforms.
- In 1994- the Malhotra committee recommended certain reforms having studied the sectors & hearing out the stakeholders. Some recommended reforms are-
- Private sectors companies should be allowed to promote insurance companies.
- Foreign promoters should also be allowed.
- Govt to vest its regulatory powers on an independent regulation body answerable to parliament.
- In 1999 – IDRA was set up as an autonomous body under the IRDA Act. 1999.

IRDA – Formation

In 1999, following the recommendation of the Malhotra Committee report IRDA was constituted to regulate & develop the insurance industry, promote competition & ensure fair & developmental practices in the sectors. In December 2000, the General Insurance Corporation of India‘s subsidiaries were hived off as independent companies & GIC was converted into a national reinsurer.

Recent Initiatives:

Recently the Finance Minister of India announced the setting of an insurance repository system. An Insurance Repository is a facility to help policyholders buy &keep an insurance policy in electronic form, rather than as a paper document. Insurance Repositories, like share depositories or mutual fund transfers agencies, will hold electronic records of insurance policies issued to individuals & such policies are called electronic policies or e-policies.

Pension Funds regulatory & Development Authority (PFRDA)

What is a pension?

A pension is a type of retirement plan that provides monthly income after you retire from

your position. The employer is required to contribute to a pool of funds invested on the employee's benefit. As an employee, you may contribute part of your wages to the plan, too.

Not all businesses offer these plans. They're most common in government organizations and large corporate entities.

What is PFRDA?

Pension Fund Regulatory and Development Authority is a regulatory body that was established in 2003 with an aim of promoting, regulating, and developing the pension sector in India. Initially, PFRDA was formulated for Government sector employees only but gradually, its services extended to all citizens of India and NRIs including self-employed individuals.

The PFRDA is a regulatory authority. It was established by GOI on August 23 and is authorized by the ministry of finance, Dept Of Financial Service.

PFRDA promotes old age income security by establishing, developing & regulating pension funds & protects the interest of subscribers to schemes of pension funds & related matters.

PFRDA is responsible for the appointment of various intermediate agencies such as Central Record Keeping Agency (CRA), Pension Funds Managers, Custodian, (NPS) National Pension Schemes, Trustee Bank, etc.

Pension Fund Regulatory and Development Authority is the regulatory body under the jurisdiction of the Ministry of Finance, Government of India for overall supervision and regulation of pension in India.

The Government of India had, in the year 1999, commissioned a national project titled "OASIS" (an acronym for old age social & income security) to examine policy related to old age income security in India.

Based on the recommendations of the OASIS report, the Government of India introduced a new Defined Contribution Pension System for the new entrants to Central/State Government service, except to Armed Forces, replacing the existing system of Defined Benefit Pension System.

On 23 August 2003, the Interim Pension Fund Regulatory & Development Authority (PFRDA) was established through a resolution by the Government of India to promote, develop and regulate the pension sector in India.

The contributory pension system was notified by the Government of India on 22 December 2003, now named the National Pension System (NPS) with effect from 1 January 2004.

The NPS was subsequently extended to all citizens of the country w.e.f. 1 May 2009 including self-employed professionals and others in the unorganized sector on a voluntary basis.

The Pension Fund Regulatory & Development Authority Act was passed on 19 September 2013 and the same was notified on 1 February 2014. PFRDA is regulating NPS, subscribed by employees of Govt. of India, State Governments and by employees of private institutions/organizations & unorganized sectors. The PFRDA is ensuring the orderly growth and development of the pension market.

The preamble of PFRDA states that the aims of the authority are – ***"to promote old age income security by establishing, developing and regulating pension funds, to protect the interests of subscribers to schemes of pension funds and for matters connected therewith or incidental thereto."***

PFRDA is headquartered in New Delhi with various regional offices spread across the country.

Role & Function of PFRDA

Subject to the provision of this Act any other law for the time being in force, the Authority shall have the duty to regulate, promote & ensure orderly growth of the National Pension System & pension Scheme to which this Act applies & to protect the interest of the subscribers of such system & schemes

The functions of the Authority have been defined by the bill as follows:

- Approve & regulate the National Pension System & other notified pension schemes.
- Approving terms & conditions & laying down norms for the management of the corpus of the pension funds, including investment guidelines under such scheme.
- Registering & regulating intermediaries, issuing, renewing, modifying, withdrawing, suspending, or canceling certificate of registration.
- Protecting the interest of subscribers by ensuring the safety of the contribution of subscribes to various schemes ensuring that the operation costs under the National Pension System are economical & reasonable establishing efficient Grievance Redressal mechanisms, adjudicating disputes between intermediaries & subscribers.
- Collecting data undertaking studies, research & projects.
- Undertaking steps for educating subscribers & the general public on issues relating to pension, retirement saving & related issues and training of intermediaries.
- Specify by regulations the forms & manner in which books of accounts shall be maintained Calling for information, undertaking an inspection of conducting enquires & investigation including audit of intermediaries & other entities or organizations connected with pension funds.
- Regulating National Pension System and other schemes applicable under PFRDA Act.
- Protecting the interest of pension fund users.
- Developing and regulating pension funds.
- Regulating and registering intermediaries.
- Establishing grievance redressal.
- Approving terms, schemes, and norms for corpus management in pension funds.
- Settlement of disputes in intermediaries and subscribers.
- Promoting a regulatory organization with a pension mechanism.
- Regulating the assets which have been regulated.
- Making subscribers and the general public aware and training intermediaries regarding retirement savings, pension, and other issues.
- Conducting investigation, inquiries, and audits and calling for information about intermediaries and other pension bodies.

Structure of PFRDA

The top-level hierarchy of PFRDA consists of the following members:

- A Chairperson
- The three whole-time members

- The three part-time members.

This level is appointed by Central Govt from amongst person of ability, integrity & standing & having knowledge & experience in economics, finance, law or administrative matters with at least one person from each discipline. The chairperson & every whole-time member shall hold office for the term of 5 yrs from the date on which he enters upon his office & shall be eligible for reappointment.

Intermediate agency

Central Record Keeping Agency (CRA)

Central Record Keeping Agency performs the following functions –

- Administration and record-keeping of all information of customers who are registered under the National Pension System.
- Issuing of PRAN or Permanent Retirement Account Number for customers who have availed savings plan under the National Pension Scheme
- Acting as an operational intermediary between PFRDA and other entities like Pension Funds, Trustee Bank, etc.
- Monitoring contributions of NPS subscribers and updating various intermediaries about the same.
- Furnishing periodic and updated PRAN statements to all subscribers on a regular basis.
- Overseeing the settlement of funds that have been invested and the subsequent units allotted to subscribers.

Pension Fund Managers (PFMs)

Listed below are some of the most important functions of the PFMs:

- Pension Fund Managers essentially are mandated to invest and manage funds of subscribers enrolled in the National Pension System.
- Investment of contribution of the subscriber as per rules and guidelines of the PFRDA.
- Maintain books and records of the investment and flow of funds.
- Construction of portfolio of customers who choose auto-allocation of funds.

- Reporting to PFRDA on a regular basis.
- Public disclosure of financial information from time to time as per guidelines issued by PFRDA.

Point of Presence Agencies (PoPs)

The third and most public-facing entity of the PFRDA is the Point of Presence Agencies. Following are the functions that it performs:

- Receive and analyze the duly filled application form along with KYC documentation, furnished by customers who register for the NPS scheme.
- To verify KYC documents as and when required.
- To collect and verify NPS contributions made by subscribers via various channels like cash, Demand Draft, cheques, and so on.
- To deduct and collect the NPS application fee and to furnish a receipt of the same to the subscribers.
- To upload contribution files of subscribers to the Central Record-Keeping Agency system.
- To maintain records of all transactions that happen for various NPS accounts of customers.
- Carry out changes in subscriber details as per requests made by subscribers.
- Handle requests and complaints with regards to contributions made towards NPS and another such request.

Trustee Bank

This is also one of the intermediaries of PFRDA. Following are the tasks that this agency performs:

- Receives funds for NPS from all over the country via zonal and regional offices.
- Verifies amounts paid by the zonal offices.
- Fund transfers with discrepancies are returned to the zonal office or bank involved and correct transfers are sought.
- Prepares Fund Receipt Information by consolidating all funds received to NPS.
- Transfer funds according to instructions by CRA for settlement of funds for various entities.

- Reconcile daily balances in accordance with CRA.
- Maintain records of contributions by nodal offices and other documents pertaining to the same.

Custodian

- Does the job of maintaining accounts of securities and assets held by customers.
- Collecting accrued benefits on securities and assets.
- Acting as a Domestic Depository and performing functions related to the same.
- Informing about the actions that are to be taken or have been taken by the issuer of securities.
- Maintains and reconciles records of services.

Evolution

India has an absence of a country-wide social security system, while the aging & social change are important considerations for introducing pension reforms in the unorganized sector, fiscal stress of defined benefits pension system was the major factor driving pension reforms for employees.

With the onset of the economic reforms in the early pension liabilities suddenly started becoming an important consideration as the system was defined benefit plan .(pay as you retire, with a fixed amount of income)

The represented an open-ended from the govt fiscal expenditure & had potential to drain govt finances.

With a view to examine all such issues and to achieve a better pension regime without letting the future pension liabilities get out of hand & finally to improve pension coverage, GoI set up an Old Age Social & Income Security (OASIS) committee under the chairmanship of Shri S.A.Dave in 1998 to devise a new pension system- for India.

Besides this, 2 other studies were undertaken -: a High-Level Expert Group (HLEG) under the chairman of Shri B.K.Bhattacharya in 2001 to review the Defined Benefit pension system

& a working group under Shri N. Rangachary, chairman, IRDA on pension reforms in the unorganized sector.

All studies pointed to the need to switch over from a defined benefit pension scheme to a defined contribution pension scheme.

PFRDA Formation:

The GOI Introduced the New Pension System (NPS) on January 1, 2004, & constituted an interim regulator, the Interim Pension Funds Regulatory & Development Authority (PFRDA)

An ordinance was promulgated on December 29, 2004, for setting up a statutory Pension Fund Regulatory & Development Authority (PFRDA).

Subsequently, the Pension Fund Regulatory & Development Authority Bill, 2005 was initially introduced in Lok Sabha in March 2005 to provide for a statutory PFRDA.

The revised PFRDA Bill 2011 was introduced in Lok Sabha on March 24, 2011, to provide for a statutory regulatory body, the Pension Fund Regulatory & Development Authority (PFRDA) under the provision of Bill.

The legislation sought to empower PFRDA to regulate the New Pension System (NPS). The Parliament passed the PFRDA Bill in September 2013.

The PFRDA Act received the assent of the president on September 18, 2013, and was notified on(became effective from) February 1, 2014,

Other Regulators

Ministry of Corporate Affairs (MCA)

It is concerned with the administration of the Companies Act 2013, the Companies Act 1956, the Limited Liability Partnership Act 2008 & other allied acts & rules & regulations framed there-under mainly for regulating the functioning of the corporate sector in accordance with the law. The Ministry is also responsible for administering the Companies Act 2002 to prevent practices having an adverse effect on competition, to promote & sustain competition, in markets to protect the interest of the consumer through the commission set up under the Act. The MCA also supervises the three professional bodies, the Institute of Chartered Accountants of India (ICAI), the Institute of Company Secretaries of India (ICSI) & the Institute of Cost Accountants of India (ICAI).

The objective & functions of the MCA are as follows:

Objective

- Simplified laws governing corporate sector & effective compliance.
- Speedy & transparent service delivery, access to public information, and effective monitoring of statutory compliance.
- To encourage the corporate sector to adopt good corporate governance practices & corporate social responsibility.
- Promote investors' education & awareness for the creation of an appropriate business environment that facilitates the growth of corporate sectors.
- To develop capacity building & secure policy advisory through IICA (Indian Institute of Corporate Affairs)-is a central civil service training institute under the jurisdiction of MCA.
- Administration of Companies Act and other Acts under the purview of Ministry.
- To promote competition & curb anti-competition practices.

Functions

- Administration of the Companies Act 1956 & other related Acts.
- Formulating rules & regulations under various Acts.
- Convergence of Indian Accounting Standards with IFRS. (International Financial Reporting standards).
- Implementation of Competition Act.
- e-Governance in MCA.
- Building a system for early detection of irregularities incorporates functioning.
- Undertaking investors education & awareness programs.

- To undertake an investigation of serious frauds.

Forward Market Commission (FMC)

Forward market commission headquartered in Mumbai is a regulatory authority for the Commodity futures market in India. It is a statutory body set up under the Forward Contracts (Regulation) Act 1952.

The role & function of the FMC are:

- To advise the central government in respect of any matter arising out of the administration of the forward contracts (regulation) Act 1952.
- To keep forward markets under observation & to take such action, in the exercise of the power assigned to it by or under the Act.
- To collect & publish information regarding the trading condition in respect of goods to which any of the provisions of the Act is applicable.
- To make recommendations generally with a view to improving the organization & working of forward markets.
- To undertake the inspection of the accounts & other documents of any recognized association or registered association or any member of such association whenever it considers it necessary.
- The commission functions under the administrative control of the ministry of finance, the Department of Economic Affairs. The FMC consists of not less than two but not exceeding four members appointed by the central government, out of the one being nominated by the Central Government to be the Chairman of the Commission.

Ministry of Finance (MoF)

The Ministry of Finance is an important ministry within the Govt of India. It concerns itself with taxation, financial legislation, financial institutions, capital markets, center & state finance, & union budget. The ministry of finance is the controlling authority of the civil services including the Indian Revenue Service, Indian Economic Service, Indian Cost Accounts Service & Indian Civil Account Service. The Ministry comprises 5 departments.

The department of economic affairs (DEA) formulates & monitors India's economic policies & programs. It also prepares the Union Budget, monitors external resources,

sovereign borrowing, investments & foreign exchange resources including the balance of payments. The department oversees almost 54 acts & subordinates legislations.

The department of expenditure oversees the public financial management system. It also oversees pre-sanction appraisal of major schemes/projects handling the bulk of the central budgetary resources transferred to states, implementing recommendations of finance & central pay commission, overseeing the expenditure management. The expenditure department also looks after audits & preparation of central Govt Accounts.

The department of Revenue exercises controls in respect of matters relating to all the direct & indirect Union Taxes through two statutory Boards namely, the Central Boards of Direct taxes(CBDT) & the Central Board of excise & Customs (CBEC). The department oversees 20 Acts & Subordinate legislation.

The Department of Financial Service covers the banking & insurance regulators & banks, Insurance & Financial services provided by various govt agencies & Private corporations. It also covers pension reforms & Industrial finance & Micro, Small & Medium enterprises.

The department of Disinvestment came into existence in May 2004 and took up all the functions responsible for the system policy approach to disinvestment & privatization of Public Sector Units (PSUs).

Thus the ministry of Finance is an umbrella regulator which is also responsible for the regulation of other financial sector regulators.

Financial Instruments & Services

Introduction to Financial Instrument

Financial instruments are the financial assets, securities, and claims. They may be viewed as financial assets and financial liabilities.

Financial assets represent claims for the payment of a sum of money sometime in the future (repayment of principal) and or periodic payment in the form of interest or dividend. They represent a promise to pay some portion of prospective income and wealth to others.

Characteristics of Financial Instruments:

Liquidity: Financial instruments provide liquidity. These can be easily & quickly converted into cash.

Marketing: Financial instruments facilitate easy trading on the market. They have a ready market.

Collateral value: Financial Instruments can be pledged for getting loans.

Transferability: Financial instruments can be easily transferred from person to person.

Maturity period: The maturity period of financial instruments may be short-term, medium-term, or long-term.

Transaction cost: Financial instruments involve buying and selling costs. The buying and selling costs are called transaction costs. These are lower.

Risk: Financial instruments carry risk. This is because there is uncertainty with regard to payment of principal or interest or dividend as the case may me

Future trading: Financial instruments facilitate future so as to cover risks due to price fluctuations, interest rate fluctuations, etc.

Classification of Instruments

Financial assets and liabilities arising from the basic process of financing.

Some of the financial instruments are tradable/ transferable. Others are non-tradable/non-transferable.

Financial assets like deposits with banks, companies and post offices, insurance policies, NSCs, provident funds, and pension funds are not tradable.

Securities (included in financial assets) like equity shares and debentures, or government securities and bonds are tradable.

Hence they are transferable. In short, financial instruments are instruments through which a company raises finance.

The financial instruments may be capital market instruments or money market instruments or hybrid instruments.

The financial instruments that are used for raising capital through the capital market are known as capital market instruments.

These include equity shares, preference shares, warrants, debentures, and bonds.
These securities have a maturity period of more than one year.

Examples are treasury bills, commercial paper, call money, short notice money, certificates of deposits, commercial bills, money market mutual funds.

Financial instruments can also be classified into primary instruments and secondary instruments.

Primary instruments are instruments that are directly issued by the ultimate investors to the ultimate savers.

For example, shares and debentures are directly issued to the public.

Secondary instruments are issued by the financial intermediaries to the ultimate savers.

For example, UTI and mutual funds issue securities in the form of units to the public.

The financial instruments that are used for raising and supplying money in a short period not exceeding one year through the money market are called money market instruments. Examples are treasury bills, commercial paper, call money, short notice money, certificates of deposits, commercial bills, money market mutual funds.

Hybrid instruments are those instruments that have both the features of equity and debenture. Examples are convertible debentures, warrants, etc.

Financial instruments may also be classified as cash instruments and derivative instruments.

Cash instruments are financial instruments whose value is determined directly by markets.

Derivative instruments are financial instruments that derive their value from some other financial instrument or variable.

Capital is made up of debt & equity. Debt is borrowed money, for example, money borrowed from financial institutions, etc.

Equity is shareholders' money called equity capital.

Capital is required either for new business or to expand the existing business.

Capital comes from different sources.

The debt holders do not have a share in the profit. They can claim to ask for the return of money borrowed with interest. Their claim is limited to fixed return.

Owned & borrowed Capital

There are two sources of raising fixed capital by a company:

- Owned capital
- Borrowed capital

In order to finance fixed capital, a company depends on long-term types of finance. It makes use of both the sources, owned as well as borrowed.

Owned capital is raised by the issue of shares & plowing back of profits.

Borrowed capital is raised by issuing debentures, public deposits & loans from industrial & financial institutions.

A company cannot make the mistake of financing fixed assets out of short-term sources of finance as the funds invested in fixed assets are permanently sunk into the business & are not convertible into cash at a short notice.

The sources of fixed capital, both owned & borrowed are as follows:

1. Equity shares (owned capital) – According to the companies ordinance 1984 a company can raise capital by issuing equity or ordinary shares only. The equity share is a permanent source of capital. The company has not to repay it except under liquidation. Equity shareholders are the real owners of the company. As dividend is to be paid out of the profits, these are in no way a burden on the resources of the company.

2. Ploughing back of profit (owned capital) – it is a process of retaining profit years after years & their utilization in the business for the development of the business. The technique of reinvestment of profit or plowing back of profits is employed for making the company self–dependent on finances. This method is also employed for expansion of business, the redemption of loans & debentures, etc.

3. Debentures (borrowed funds) - a company may raise long-term finance through public borrowing. These loans are raised by the issue of debentures. A debenture is an instrument issued by a company to acknowledge the loan taken under the company's seal. A debenture holder is the creditor of the company. The company pays a fixed rate of interest on debenture.

4. Loans from industrial & financial institutions (borrowed capital)- another important source of raising long-term finance is loans from financial institutions. The loans are obtained both in local & foreign currency for the purchase of machinery equipment's etc.

Debt Instruments

A financial instrument in which the issuer agrees to pay investor interest plus repay the amount borrowed is a debt instrument.

Debt instruments are popularly known as fixed income instruments.

It can be in form of notes, bonds, or loans.

The interest payments that must be made by the issuer are fixed contractually.

It creates a financial obligation that promises to pay a specified sum of money at a specified future date.

Features & Characteristics

Debt instruments are negotiable financial instruments. This means that they can be legally transferred from one owner to another & can also be traded on an exchange.

The following characteristics of debt instruments:

Nominal, principal, or face value amount:
This is the amount that the issuer borrows from the investors & agrees to pay back the amount to the issuer upon maturity. This is called the principal or face value or redemption value, or maturity value.

Maturity:
It refers to the date, on which the instruments mature & the instruments have to be repaid by the issuer.
Eg a debenture issued for ten years will have a ten-year maturity, if three years have passed since the issue, the remaining period of debenture is seven yrs, these 7 yrs are referred to as terms to maturity. This is also called the term or tenure of the bond.

Coupon rate:
A coupon is the periodic interest payment that has to be made by the borrower to the lender.
A coupon rate is a rate at which interest is paid on the instruments.

Security:

Some debt instruments are secured by collateral. Eg- a housing loan, where your house is considered as a security or collateral towards the loan. This makes the instrument safer & protects the investors in case of a default.

Call & put options:
Some debt instruments also have clauses that enable either the issuer to repay earlier than the original maturity or the investor to ask for early repayment before maturity. These clauses are known as call or put options.& the dates before /on which these have to be exercised are known as call or put dates.

Types of debt instruments:

Debt instruments are classified on maturity into long-term debt instruments & short-term debt instruments. The long-term instruments have an original maturity of more than 1 year & short-term instruments have a contractual maturity of less than one year.

Long-term debt instruments.

- Debenture
- Fixed deposit
- Long term bonds
- Govt security

Short term debt instruments

- Commercial paper
- Certificate of deposits
- Treasury bills

The variety of debt instruments may be classified as follows:

- Money market instruments
- Government securities & govt guaranteed bonds
- Corporate debentures.

Money market instruments

Debt instruments that have a maturity of less than 1 year at the time of issue are called money market instruments. They do not carry an explicit interest rate .they are sold at a discount & redeemed at par value.

1. Treasury bills
2. Certificate of Deposit
3. Commercial paper

Government Securities

A govt security is a tradable instrument issued by the central govt or the state govt .such securities are short-term & long-term. The largest borrowers in India are central & state govt. govt periodically sells central govt securities. These are medium to long-term securities issued by RBI on behalf of govt. Interest payments on these bonds are typically semi-annual. The state govt also sells bonds. RBI issues on behalf of state govt.

Types of govt Securities:

Cash management bills: (CMBs) have characteristics of that of T-bill but are issued for a maturity period of fewer than 91 days. It is issued at a discount & redeemed at face value on maturity. The tenure notified amount & date of issue of the CMBs depends on the temporary requirement of govt. the announcement of there is made by the RBI through a press release that would be issued one day prior to the date of the auction that would be issued one day prior to the date of auction. The settlement of the auction is on a T+1 basis.

Dated Government securities: it is long-term securities that carry a fixed or floating coupon. Which is paid on the face value, payable at fixed time periods usually half-yearly. The tenor of dated securities can be up to 30 years.

State development loan – state govt also raises loans from the market. SDLs are dated securities issued through an auction similar to the auctions conducted for the dated securities issued by the central govt. interest is serviced at half-yearly intervals, & the principal is repaid on the maturity date.

Special securities: in addition to T- bill & dated securities issued by the govt of India special securities from time to time to entities such as oil marketing companies, fertilizer companies,

the food corporation of India, & so on as compensation to these companies in lieu of cash subsidies. The interest rate is high.

Corporate Debt/ Bonds

Bond are issued frequently by public sector companies, financial institutions, & private sector companies.

A corporate bond is a bond issued by a corporation in order to raise financing for a variety of reasons such as expansion business. The term is applied to longer-term debt instruments with maturity shorter than one year is referred to as commercial paper.

Types of corporate Bond:

Fixed-rate bonds – these are bonds on which the coupon rate is fixed for the entire life of the bond. Most govt bonds are issued as fixed-rate bonds.

Floating rate Bonds: floating rate bonds are securities that do not fix coupon rates. Floating rate bonds were first issued in India in September 1995. Interest payments fluctuate with an underlying interest rate level.

Zero-Coupon Bonds: Zero-coupon bonds with no coupon payment. Like T- Bill, they are issued at a discount to the face value. The Government of India issued such securities in the 90s; it has not issued zero-coupon bonds after that.

Capital Indexed Bonds: These are bonds, the principal of which is linked to an accepted index of inflation with indexed bonds, with the principal hedged against inflation, were first issued in December 1997.

Bonds with call/put options: bonds can also be issued with features of optionality, wherein the issuer can have the option to buy back or the investor can have the option to sell the bond to the issuer during the currency of the bond. The optionality on the bond could be exercised after the completion of five years from the date of issue on any coupon date falling thereafter

Features of corporate bonds

Collateral: collateral represents a pledge of assets in favor of bondholders. If serves as insurance against any possible default by the borrower.

Sinking Fund: A sinking Fund Provision requires issuing firm to retire a certain percentage of the bond issue at a stipulate point of time.

Protective covenants(Agreement): the bond several agreements to protect the interest of the lender. These impose restrictions on management & give bondholders greater confidence that the firm will honor its commitment.

Advantages of Debt Instruments

- Fixed & period receipts like interest
- Capital is preserved
- These instruments are more secured.
- Investment in govt bonds (gilts) is more risk-free.
- Lower volatility in comparison to the equity market.
- Variety of instruments like index-linked bonds; floating-rate notes.

Introduction to equity instrument

Equity share commonly referred to as ordinary share also represents the form of fractional ownership.

According to explanation (i)to section 43 of Companies Act, 2013 “equity share capital” with reference share capital.

Section 43 further provides for equity share capital:

- With the voting right, or
- With differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed.

Shall be liable to get the dividend.

An equity share is a perpetual liability because it signifies an owner's legal demand upon the assets of the entity in which the equity share is held.

Features & characteristics:

Equity instruments represent ownership interest voting right & control: equity shareholders have the voting rights & have the power to vote on all important matters relating to the appointment of directors, dividend declaration, etc. shareholders are entitled to vote in person or by proxy.

Limited liability: equity shares liability is limited to the extent of the investment. This is in contrast to sole proprietorship where the equity liability is not limited to the extent of the investment.

Permanent Risk capital: it is permanent in nature ie the company need not pay the equity shareholders. Moreover, equity share liability is the last one to be discharged after all claims towards the entity are met. This means that the equity share takes the full risk of whatever happens to the company. Hence equity shares are known as risk capital. Equity shares can transfer shares in the secondary market.

Dividends are not fixed: dividend payment depends upon the profits the company makes. Even if the company makes a good profit, the dividends may not get declared, alternative, the company may not have done very well but the board may still declare a dividend.

Equity shares have the right to share the profit of the company in the form of dividends & bonus shares. However, they cannot demand a declaration of dividend by the company which is left to the discretion of the BOD.

When a company is wound up, payment towards the equity share capital will be made to the respective shareholders only after payment of the claims of all the creditors & preference shareholders.

Equity shareholders enjoy different rights as members under the companies act 2013, like the right to vote on every resolution placed before the company, the right to subscribe to share at

the time of further issue of capital. Right to appoint a proxy to attend &vote at the meeting, receive notice of a meeting of members, right to inspection of various registers, etc

Types of equities share

Common Stock:

A share of common stock provides an ownership interest in the company, along with voting rights and possible dividends. Common stock may be divided into classes with different numbers of votes per share. These classes are typically designated as Class A, Class B, Class C, etc. on the stock market. Dividends are not guaranteed and may be suspended if the company struggles financially. Holders of common stock are the last to be paid if the company liquidates. To account for this risk, the dividend yield is higher than the rate paid on preferred shares.

Preferred stock:

Preferred stock also gives ownership but does not include voting rights. Holders of preferred stock are the second to be paid in a company liquidation; bondholders are first. If the stock is convertible, the shareholder has the option of converting his shares to common stock. Callable shares give the company the choice of when to make the conversion. Participating in preferred stock pays an increased dividend when the company is profitable. If you own cumulative preferred shares, you will be entitled to a retroactive payment of any suspended dividends.

Various other kinds of Financial instruments

Mutual funds

A mutual fund is a company that pools money from many investors & invests the money in stocks, bonds, short-term money-market instruments, other securities or assets, or some

combination of these investments. Combined holdings the mutual funds own are known as their portfolio. Each share represents an investor's proportionate ownership of the fund's holding & income that holding generates.

SEBI regulates the mutual fund industry in India. Mutual Funds employ expert professional teams having sound knowledge of investments to generate superior returns from the investment portfolio of the fund. The profit or losses from the investments are distributed in proportion to the investments made by the investors. There are various types of mutual funds that are spread across a wide variety of asset classes, industries, and sectors. Mutual funds were introduced in India through the formation of Unit Trust of India in 1963, with the issue of units under the scheme US-64.

Mutual Funds are operated by ASSET MANAGEMENT Companies (AMCs), each AMC may operate multiple mutual funds. As of March 31, 2014, India had 44 asset management companies operating in the country. Corporate entities make up almost 50 percent of the mutual fund investors in the country. Financial institutions make up 27 percent and retail investors make up 21 percent.

Characteristics and Features:

- Involve pooling of resources
- Have expert professional managing the funds
- Are registered and regulated by SEBI
- Can be classified in multiple ways
- Are a good way for investors to get introduced to financial markets
- Are negotiable and transferrable instruments

Types:

Equity or growth schemes

These are one of the most popular mutual fund schemes. They allow investors to participate in stock markets. Though categorized as high risk, these schemes also have a high return potential in the long run. They are ideal for investors in their prime earning stage, looking to build a portfolio that gives them superior returns over the long term. Normally an equity fund

or diversified equity fund as it is commonly called invests over a range of sectors to distribute the risk.

Equity funds can be further divided into-

Sector-specific funds:

These are mutual funds that invest in a specific sector. These can be sectors like infrastructure, banking, mining, etc., or specific segments like mid-cap, small-cap, or large-cap segments. They are suitable for investors having a high-risk appetite and have the potential to give high returns.

Tax saving funds:

These funds offer tax benefits to investors. They invest in equities and are also called Equity Linked Saving Schemes (ELSS). These types of schemes have a 3 year lock-in period. The investments in the scheme are eligible for tax deduction u/s 80C of the Income-Tax Act, 1961.

Money market funds or liquid funds:

These funds invest in short-term debt instruments, looking to give a reasonable return to investors over a short period of time. These funds are suitable for investors with a low-risk appetite who are looking at parking their surplus funds over a short term. These are an alternative to putting money in a savings bank account.

Fixed income or debt mutual funds:

These funds invest a majority of the money in debt - fixed income i.e. fixed coupon-bearing instruments like government securities, bonds, debentures, etc. They have a low-risk-low-return outlook and are ideal for investors with a low-risk appetite looking at generating a steady income. However, they are subject to credit risk.

Balanced funds:

As the name suggests, these are mutual fund schemes that divide their investments between equity and debt. The allocation may keep changing based on market risks. They are more suitable for investors who are looking at a combination of moderate returns with comparatively low risk.

Hybrid / Monthly Income Plans (MIP):

These funds are similar to balanced funds but the proportion of equity assets is lesser compared to balanced funds. Hence, they are also called marginal equity funds. They are especially suitable for investors who are retired and want a regular income with comparatively low risk.

Gilt funds:

These funds invest only in government securities. They are preferred by investors who are risk-averse and want no credit risk associated with their investment. However, they are subject to high-interest rate risk.

Bank instruments & Commercial bills:

Bank Instruments are the oldest instrument in the Indian Financial system.

Bank instruments are of various types, but are primarily classified into fund-based & non-fund-based instruments.

Fund-based instruments- involves providing funds against asset/ collateral eg term loan given to a company for expansion purpose is a fund-based instrument. Working capital loans such as overdrafts are short-term fund-based instruments.

Non-fund-based facilities: bank charges fees for services. Letter of credit is an example of non-fund-based facilities.

Bank instruments are also classified on the types of borrowers ie corporate lending (lending to large entities) & retail lending (loans to individuals).

Bank instruments are the widest used instruments in India today but these are not traded in the secondary market.

Commercial bills

Commercial bills are short term, negotiable, & self-liquidating instruments. These instruments are actually negotiable bills of exchange (regular trade bills which are accepted by commercial banks, hence the term commercial bills. Banks discount these bills using the bill as collateral to issue what is called bill discounting facilities to customers. Banks also rediscount these commercial bills with selected financial institutions such as EXIM bank & SIDBI.

Derivative Instruments

The value and characteristics of derivative instruments are based on the vehicle's underlying components, such as assets, interest rates, or indices.

An equity options contract, for example, is a derivative because it derives its value from the underlying stock. The option gives the right, but not the obligation, to buy or sell the stock at a specified price and by a certain date. As the price of the stock rises and falls, so too does the value of the option although not necessarily by the same percentage.

There can be over-the-counter (OTC) derivatives or exchange-traded derivatives. OTC is a market or process whereby securities–that are not listed on formal exchanges–are priced and traded.

In India, 4 types of derivatives are common-

Structured Instruments: structured Instruments are perhaps the most complex instruments of the financial market. These instruments have been often misunderstood & have sometimes also caused markets to destabilize.

Investopedia explains structured finance as -----

"a service that generally involves highly complex financial transactions offered by many large financial institutions for companies with very unique financing needs. These financing needs usually don't match conventional financial products such as a

loan.

Structured finance has become a major segment in the financial industry since the mid -1980s Collateralized bond obligations, collateralized debt obligations, syndicated loans & synthetic financial instruments are examples of structured financial instruments"

Structured finance is a sector of finance that was created to help transfer risk using complex legal * corporate entities. This transfer of risk, as applied to the securitization of various assets has helped provide increased liquidity or funding sources to markets like housing & to transfer risk to buyers of structured products; it also permits a financial institution to remove certain assets from their balance sheets as well as provides a means for investors to gain access to diversified asset classes.

Simply put securitization & structuring instruments are a process by which a company clubs/ slices/ cherry picks different financial assets/ debts to form a consolidated financial instrument which is issued through a separate legal entity to investors. In return, the investors get the returns on the underlying assets through the securitized instruments.

Financial Services

Financial services refer to services provided by the finance industry. It consists of a broad range of organizations that deals with the management of money. These organizations included funds & some govt sponsored enterprises. Financial services may be defined as the products & services offered by financial institutions for the facilitation of various financial transactions & other related activities.

Characteristics:

Intangibility: services are those which cannot be seen, touched, or heard. They are intangible in nature.

Customer orientation: financial services could be satisfactorily provided only when it studies the needs of its customer in detail. Only with customer interaction, new innovative services could be created & offered. Cost maturity period, liquidity criteria could be decided only after interaction with customers.

Inseparability: services are produced & consumed at the same point. It cannot be stored & consumed later on. Production & supply takes place simultaneously, which demands for perfect understanding between financial service firms & their client.

Perishability: it cannot be stored. It has to be created & delivered to the target client. They need to be supplied as per the requirement of their customer thus supplied should match between dd & ss.

Dynamism: it is dynamic in nature. They need to be changed as per social needs. The financial institution must be proactive in nature & evolve new services by visualizing expectations of the market.

Functions of Financial services

Financial services help to facilitate the exchange of goods & services in the economy.

It helps to mobilize saving from those who have sufficient to those who need it.

It helps to allocate capital funds to a party that uses it optimally.

Financial services monitor managers so as to find out the appropriate use of those funds.

It transforms risk from passive to active investors bearing risk-taking capacity.

Role of financial services

Promote Economic growth: the financial service mobilizes the savings & investments of the people, & channels them into productive investments by providing various services to people in general corporate enterprises in particular.

Inculcate the habit of saving: the financial service industry mobilizes the saving of the people by providing transformation services. It provides liability, asset & size transformation services by providing huge loans from small deposits collected from a large number of people. In this way financial service industry promotes savings.

Capital formation: financial service industry facilitates capital formation by rendering various capital market intermediary services. Capital formation I the very basis for economic growth.

Creation of employment opportunities: the financial service industry creates & provides employment opportunities to millions of people all over the world.

Contribution of GNP: recently the contribution of financial services to GNP has been increasing year after year in almost all countries.

Provision of liquidity: the financial service industry promotes liquidity in the financial system by allocating & reallocating savings & investment into various avenues of economic activity. It facilities the easy conversion of financial assets into liquid cash.

Types of financial services:

- Banking
- Insurance
- Mutual funds
- Merchant Banking
- Venture capital

Scope of Financial Services:

The scope of financial services is very wide. This is because it covers a wide range of services.

The financial services can be broadly classified into two: (a) fund-based services and (b) non-fund services (or fee-based services).

Fund-based Services:

The fund-based or asset-based services include the following:

1. Underwriting
2. Dealing in secondary market activities
3. Participating in money market instruments like CPs, CDs etc.
4. Equipment leasing or lease financing
5. Hire purchase
6. Venture capital
7. Bill discounting.
8. Insurance services
9. Factoring
10. Forfeiting
11. Housing finance
12. Mutual fund

Non-fund-based Services:

Today, customers are not satisfied with the mere provision of finance. They expect more from financial service companies. Hence, the financial service companies or financial intermediaries provide services on the basis of non-fund activities also. Such services are also known as fee-based services. These include the following:

1. Securitization
2. Merchant banking
3. Credit rating
4. Loan syndication
5. Business opportunity-related services
6. Project advisory services
7. Services to foreign companies and NRIs.
8. Portfolio management
9. Merger and acquisition
10. Capital restructuring
11. Debenture trusteeship
12. Custodian services
13. Stockbroking

The most important fund-based and non-fund-based services (or types of services) may be briefly discussed as below:

A. Asset/Fund Based Services

1. Equipment leasing/Lease financing:

A lease is an agreement under which a firm acquires a right to make use of a capital asset like machinery etc. on payment of an agreed fee called lease rentals. The person (or the company) who acquires the right is known as the lessee. He does not get the ownership of the asset. He acquires only the right to use the asset. The person (or the company) who gives the right is known as the lessor.

2. Hire purchase and consumer credit:

Hire purchase is an alternative to leasing. Hire purchase is a transaction where goods are purchased and sold on the condition that payment is made in installments. The buyer gets only possession of goods. He does not get ownership. He gets ownership only after the payment of the last installment. If the buyer fails to pay any installment, the seller can repossess the goods. Each installment includes interest also.

3. Venture capital:

Venture capital simply refers to capital that is available for financing new business ventures. It involves lending finance to the growing companies. It is the investment in a highly risky project with the objective of earning a high rate of return. In short, venture capital means long-term risk capital in the form of equity finance.

4. Bill discounting:

Discounting of bills is an attractive fund-based financial service provided by finance companies. In the case of a time bill (payable after a specified period), the holder need not wait till maturity or due date. If he is in need of money, he can discount the bill with his banker. After deducting a certain amount (discount), the banker credits the net amount in the customer's account. Thus, the bank purchases the bill and credits the customer's account with the amount of the bill less discount. On the due date, the drawee makes payment to the banker. If he fails to make payment, the banker will recover the amount from the customer who has discounted the bill. In short, discounting bill means giving loans on the basis of the security of a bill of exchange.

5. Housing finance:

Housing finance simply refers to providing finance for house building. It emerged as a fund-based financial service in India with the establishment of the National Housing Bank (NHB) by the RBI in 1988. It is an apex housing finance institution in the country. Till now, a number of specialized financial institutions/companies have entered the field of housing finance. Some of the institutions are HDFC, LIC Housing Finance, Citi Home, Ind Bank Housing, etc.

6. Insurance services:
Insurance is a contract between two parties. One party is the insured and the other party is the insurer. Insured is the person whose life or property is insured with the insurer. That is, the person whose risk is insured is called insured. The insurer is the insurance company to whom risk is transferred by the insured. That is the person who ensures the risk of the insured is called the insurer. Thus insurance is a contract between an insurer and an insured. It is a contract in which the insurance company undertakes to indemnify the insured on the happening of a certain event for payment of consideration. It is a contract between the insurer and insured under which the insurer undertakes to compensate the insured for the loss arising from the risk insured against.

7. Mutual fund:
Mutual funds are financial intermediaries which mobilize savings from the people and invest them in a mix of corporate and government securities. The mutual fund operators actively manage this portfolio of securities and earn income through dividends, interest, and capital gains. The incomes are eventually passed on to mutual fund shareholders.

Non-Fund Based/Fee-Based Financial Services

1. Merchant banking:
Merchant banking implies investment management. Companies raise capital by issuing securities in the market. Merchant bankers act as intermediaries between the issuers of capital & the investors who purchase these securities. Merchant banking is the financial intermediation that matches the entities that need capital & those that have the capital for investment. The services provided by merchant bankers include management of mutual

funds, public issues, etc. it involves dealing with the corporate clients & advising them on various issues like –mergers, acquisitions, public issues, etc.

2. Credit rating:

Credit rating means giving an expert opinion by a rating agency on the relative willingness and ability of the issuer of a debt instrument to meet the financial obligations in time and in full. It measures the relative risk of an issuer's ability and willingness to repay both interest and principal over the period of the rated instrument. It is a judgment about a firm's financial and business prospects. In short, credit rating means assessing the creditworthiness of a company by an independent organization.

3. Stockbroking:

Now stockbroking has emerged as a professional advisory service. A stock broker is a member of a recognized stock exchange. He buys, sells, or deals in shares/securities. It is compulsory for each stock broker to get himself/herself registered with SEBI in order to act as a broker. As a member of a stock exchange, he will have to abide by its rules, regulations, and bylaws.

4. Custodial services:

In simple words, the services provided by a custodian are known as custodial services (custodian services). Custodian is an institution or a person who is handed over securities by the security owners for safe custody. Custodian is a caretaker of public property or securities. Custodians are intermediaries between companies and clients (i.e. security holders) and institutions (financial institutions and mutual funds). There is an arrangement and agreement between custodians and real owners of securities or properties to act as custodians of those who hand over it. The duty of a custodian is to keep the securities or documents under safe custody. The work of a custodian is very risky and costly in nature. For rendering these services, he gets a remuneration called custodial charges. Thus custodial service is the service of keeping the securities safe for and on behalf of somebody else for a remuneration called custodial charges.

5. Loan syndication:

Loan syndication is an arrangement where a group of banks participates to provide funds for a single loan. In loan syndication, a group of banks comprising 10 to 30 banks participates to provide funds wherein one of the banks is the lead manager. This lead bank is decided by the corporate enterprises, depending on confidence in the lead manager. A single bank cannot

give a huge loan. Hence a number of banks join together and form a syndicate. This is known as loan syndication. Thus, loan syndication is very similar to consortium financing.

6. Securitization (of debt):
Loans given to customers are assets for the bank. They are called loan assets. Unlike investment assets, loan assets are not tradable and transferable. Thus loan assets are not liquid. The problem is how to make the loan of a bank liquid. This problem can be solved by transforming the loans into marketable securities. Now loans become liquid. They get the characteristic of marketability. This is done through the process of securitization.

Securitization is financial innovation. It is the conversion of existing or future cash flows into marketable securities that can be sold to investors. It is the process by which financial assets such as loan receivables, credit card balances, hire purchase debtors, lease receivables, trade debtors, etc. are transformed into securities. Thus, any asset with predictable cash flows can be securitized.

Securitization is defined as a process of transformation of illiquid assets into security which may be traded later in the opening market. In short, securitization is the transformation of illiquid, non-marketable assets into securities that are liquid and marketable assets. It is a process of transformation of assets of a lending institution into negotiable instruments.

Financial Institution

Introduction

Financial Institutions are an important component of the financial system.

Financial institutions are also known as financial intermediaries. This is because they collect the savings from the savers and pass on the same to desired channels. They provide finance for the development of various sectors of the economy such as industry, agriculture, service, etc. Thus financial institutions play an important role in the financial system or economy.

Role of Financial Institution in the Financial System

Financial institutions are financial intermediaries.

They provide the means and mechanism of transferring the resources from those whose income is more than expenditure to those who need these resources for productive purposes.

The savings of the savers will reach the borrowers through the financial intermediaries in the form of financial instruments such as shares, stocks, debentures, deposits, loans, etc. Thus, they play the role of intermediate between savings and investments.

They provide safety, liquidity and ensure a return for savings.

Financial institutions develop saving habits among the people.

They mobilize huge amounts of savings for industrial development as productive capital. The financial institutions supply the capital to the small, medium, and large scale industries in India in the form of capital, venture capital, and services to promote industrial growth in India.

These contribute to the growth and development of industries, agriculture, etc.

Classification of Financial Institutions

All financial institutions in India may be broadly clarified into two-banking financial institutions and non-banking financial institutions.

Banking Financial Institutions

Banking financial institutions are those financial institutions that carry on banking activities. The banking business is carried on by these institutions after obtaining approval under Banking Regulation Act, 1949 and RBI. It accepts deposits from the public. It lends money to people engaged in commerce, industry, and agriculture. It finances foreign trade and deals in

foreign exchange. It provides short, medium, and long-term credit. It acts as an agent of RBI. It deals in stocks and shares, etc.

Banking financial institutions mainly comprise commercial banks.

Commercial Banks

Commercial banks are those banks that perform all kinds of banking functions such as accepting deposits, advancing loans, credit creation, & agency functions.

They usually advance short-term loans to customers.

Commercial banks make money by providing and earning interest from loans such as mortgages, auto loans, business loans, and personal loans. Customer deposits provide banks with the capital to make these loans.

Other services include bank & credit cards, private banking, custody & guarantee, etc

Features of commercial bank:

It operates for profit.

It accepts deposits from the general public & extends loans to households, firms & the govt.

Withdrawal by means of an instrument, whether a cheque or otherwise.

Another distinguishing feature of commercial banks is that a large part of their deposits is demand deposit with-drawable & transferable by cheque.

Functions of the commercial bank

I. Primary Functions

These are further classified into 2 categories

i) Accepting Deposits: -

Deposits are the capital of bankers. Therefore, it is the first Primary function of the banker. He accepts deposits from those who can save and lend them to needy borrowers. The size of operation of every bank is determined by the size and nature of Deposits. To attract the saving from all sorts (categories) of individuals,

Commercial banks accept various types of deposit accounts are:

a) Fixed Deposits
b) Current Deposits
c) Saving Bank account
d) Recurring Deposits

ii) Lending Loans: -

The 2nd important function of the commercial bank is advancing loans. Bank accepts deposits to lend it at a higher rate of interest. Every Commercial Bank keeps the rate of interest on its deposit at a lower level or less than what it charges on its loans. The banker advances different types of loans to the individual and firms. They are: - a) Overdraft b) Cash Credit c)Term Loan d) Discounting Bill

II) Secondary Functions

i) Agency functions:

Bankers act as an agent to the customers it means he performs certain functions on behalf of the customer's such services are called Agency Services.

Example:
a) Bank pays the electricity bill, water bill, Insurance Premium, etc.
b) They guide the customer in Task Planning.
c) Bank provides a safety locker facility.
d) Pay salaries of customers' employees.

ii) General Utility Services: -

Bankers are the past of society. They offer several services to the general public they are:-

a) It provides cheap remittance (transfer) facilities.

b) The banks issue traveler cheques for safe traveling to its customers.

c) Banks accept and collect foreign Bills of Exchanges.
d)Other than these services the bankers also provide ATM services, Internet

Banking, Electronic fund transfer (EFT), E-Banking to provide quick and proper services to their customers.

iii) Credit Creation: -
It is a unique function of Commercial Banks. When a bank advances a loan to its customer it doesn't lend cash but opens an account in the borrower's name and credits the amount of loan to that account. Thus, whenever a bank grants a loan, it creates an equal amount of bank deposits.

The creation of deposits is called Credit Creation. In simple words, we can define Credit creation as multiple expansions of deposits. The creation of such deposits will result in an increase in stock deposits. The creation of such deposits will result in an increase in the stock of money in an economy.

II. Non-Banking Financial Institutions

These are the financial institutions that are not permitted to carry on the banking activities as per the Banking Regulation Act, 1949 and RBI regulations.

These institutions have been established by special legislation to provide finance to specified categories of industries or persons.

Classification of Non-Banking Financial Institutions:

Non-banking financial institutions can be classified into three. They are:

1. All-India Financial Institutions or All-India Development Banks or Specialized Financial Institutions.
2. State Level Financial Institutions.
3. Investment Institutions.

Developmental bank

This category of banking institution was developed in response to the need for the establishment of specialized financial interests of investors in need for medium & long-term finance for accelerated development of an economy.

In simple words, development banks are specialized financial institutions providing medium long–term credit for the creation or expansion of agriculture, commercial & industrial enterprises in developing countries.

Features of a Development Bank:

Following are the main characteristic features of a development bank:

1. It is a specialized financial institution.
2. It provides medium and long-term finance to business units.
3. Unlike commercial banks, it does not accept deposits from the public.
4. It is not just a term-lending institution. It is a multi-purpose financial institution.
5. It is essentially a development-oriented bank. Its primary objective is to promote economic development by promoting investment and entrepreneurial activity in a developing economy. It encourages new and small entrepreneurs and seeks balanced regional growth.
6. It provides financial assistance not only to the private sector but also to the public sector undertakings.
7. It aims at promoting the saving and investment habit in the community.
8. It does not compete with the normal channels of finance, i.e., finance already made available by the banks and other conventional financial institutions. Its major role is of a gap-filler, i. e., to fill up the deficiencies of the existing financial facilities.
9. Its motive is to serve the public interest rather than to make profits. It works in the general interest of the nation.

Need of Development banks

To plug the gap in the financial system of the inadequacy of commercial banks services that are rarely concerned with long-term capital financing

Development banks act as a catalyst to development by financing small, independent manufacturing & industrial enterprises. In order to promote speedy industrial expansion.

Development banks are organized to achieve the preparation, appraisal, financing, implementation & evolution of investment projects & programs.

This kind of bank also provides technical assistance to improve the quality of the projects & reduce the risk.

As these banks provide long-term loans for a longer duration, they tend to create long-term assets which are good for the economic development of an economy.

Functions of development banks

Development banks are specialized banks that are established for a specified purpose in the economy. Their functions are therefore aimed at developing those sectors in which they are established for. However, they perform two broad functions which include the banking functions & the development functions.

1) Banking functions:-

Development Banks provide long term & medium term finance/loans for commerce, industry & agriculture as well as general development projects.

Development banks make funds available in the form of equity to development projects

Development functions

Development banks provide promotional activities such as identifying investment proposals.

Development bank facilities the establishment of institutions & enterprises which fill specific gaps in the financial system.

They help to stimulate their nation's capital market by selling their own stocks and bonds and or selling & using the proceeds to invest in new enterprises.

Development bank provides their clients with technical skills & advice at the preparatory & implementation stages of projects.

They provide managerial assistance to their clients in project preparation & evaluation.

Development banks ensure that allocations to projects are in line with the defined economic, social & political priorities of the govt.

Development banks ensure efficient allocation to scarce financial resources in the development planning projects.

They thus help to quicken the pace of economic development.

Development of financial institutions in India

Important development or specialized financial institutions may be discussed as follows:

Industrial Finance Corporation of India (IFCI)

The IFCI is the first Development Financial Institution in India.

It is a pioneer in development banking in India. It was established in 1948 under an Act of Parliament. The main objective of IFCI is to render financial assistance to large-scale industrial units, particularly at a time when ordinary banks are not forthcoming to assist these concerns. Its activities include project financing, financial services, merchant banking, and investment.

Till 1993, IFCI continued to be a Developmental Financial Institution. After 1993, it was changed from a statutory corporation to a company under the Indian Companies Act, 1956, and was named IFCI Ltd with effect from October 1999.

Functions of IFCI

Functions of IFCI can be classified into three: (a) financial assistance (b) Promotional activities, and (c) financial Services.

(a) Financial Assistance:

IFCI renders financial assistance in one or more of the following forms:

1. Guaranteeing loans raised by industrial concerns which are repayable within a period of 25 years.
2. Underwriting the issue of stock, shares, bonds, or debentures by industrial concerns but must dispose of such securities within 7 years.
3. Granting loans or advances to or subscribing to debentures of industrial concerns, repayable within 25 years.
4. Acting as agent for the Central Govt. and for the World Bank in respect of loans sanctioned by them to industrial concerns.
5. Granting loans to industrial units.
6. Guaranteeing deferred payments by importers of capital goods, which are able to obtain this concession from foreign manufacturers.
7. Guaranteeing loans raised by industrial concerns from scheduled banks or state cooperative banks.
8. Guaranteeing with the prior approval of the Central Govt. loans rose from any bank or financial institution in any country outside India by industrial concerns in a foreign country.

(b) Promotional Activities:

The IFCI has been playing a very important role as a financial institution in providing financial assistance to eligible industrial concerns. It is playing a promotional role too. It has been creating industrial opportunities. It discovers the opportunities for promoting new enterprises. It helps in developing small and medium-scale entrepreneurs by providing them guidance through its specialized agencies in the identification of projects, preparing project profiles, implementation of the projects, etc. It acts as an instrument of accelerating industrial growth and reducing regional industrial and income disparities.

(c) Financial Services: The following financial services are provided by IFCI.

(i) Corporate counseling for financial reconstruction

(ii) Assistance in settlement of terms and conditions with foreign collaborators.
(iii) Revival of sick units
(iv) Financing of risky projects
(v) Merchant banking services

The IFCI has promoted ICRA Ltd, a credit rating agency to help investors undertake investment decisions. It has also established Management Development Institute (MDI) with the objective of imparting training in modern management techniques to entrepreneurs, govt. officers, and people from the public and private sectors.

Industrial Development Bank of India (IDBI)

The IDBI was established on July 1, 1964, under an Act of Parliament. It was set up as the central coordinating agency, leader of development banks, and principal financing institution for industrial finance in the country. Originally, IDBI was a wholly-owned subsidiary of RBI. But it was delinked from RBI w.e.f. Feb. 16, 1976.

IDBI is an apex institution to coordinate, supplement and integrate the activities of all existing specialized financial institutions. It is a refinancing and re-discounting institution operating in the capital market to refinance term loans and export credits. It is in charge of conducting techno-economic studies. It was expected to fulfill the needs of rapid industrialization.

The IDBI is empowered to finance all types of concerns engaged or to be engaged in the manufacture or processing of goods, mining, transport, generation and distribution of power, etc., both in the public and private sectors.

Assistance

The composition of assistance given by IDBI may be broadly grouped as direct assistance, indirect assistance, and Promotional activities.

Direct Assistance:
Direct assistance takes the form of loan/soft loans, underwriting/subscriptions to shares and debentures, and guarantees.

Indirect Assistance:
It provides assistance to tiny, small, and medium enterprises indirectly by way of refinancing of loans granted by SFCs, commercial banks, co-operative banks, and regional rural banks, through discounting of bills of exchange arising out of the sale of indigenous machinery on deferred payment basis and seed capital assistance to new entrepreneurs through SFCs, etc.

Promotional Activities:

These include the following:

(a) Assistance for the development of backward areas:
This is provided through direct financial assistance at concessional terms and through concessional refinance assistance to projects located in specified backward areas/districts.

(b) Assistance by way of seed capital scheme:
This is to help technician entrepreneurs who have technically feasible and economically viable projects but do not have sufficient capital.

(c) A large range of consultancy services:
Another promotional scheme is the setting up of TCOs with the principal idea of providing different types of consultancy services to small and medium enterprises, Government departments, commercial banks, and others engaged in industrial development. It also provides assistance to voluntary agencies for setting up science and technology entrepreneurship parks etc., under its network of promotional activities.

In order to boost the capital market as well as to play its catalyst role in the development and promotional activities for the benefit of industry, IDBI has set up Small Industries Development Fund, Stockholding Cooperation of India, SEBI, National Stock Exchange of India, OTC Exchange of India, Entrepreneurship Development Institute of India, SCICI, TFCI, mutual fund, and commercial bank.

Functions of IDBI

1. It coordinates the operation of other institutions providing term finance to industries.
2. It provides assistance to medium and large industries by way of direct finance and refinance of industrial loans.

3. It extends resource support to all Indian and state-level financial institutions and other financial intermediaries.
4. It renders services like asset credit equipment finance, equipment leasing, and bridge loans.
5. It also undertakes merchant banking.
6. It provides technical and administrative assistance to industrial concerns.
7. It guarantees deferred payments due to any industrial concern. It guarantees loans raised by industrial concerns from any financial institution.
8. It promotes and develops key industries which are necessary to meet the overall needs of the economy.
9. It undertakes techno-economic studies and surveys on its own with a view to promoting the establishment of new enterprises.

Small Industries Development Bank of India (SIDBI)

On April 2, 1990, the Small Industries Development Bank of India (SIDBI) was set up as a wholly-owned subsidiary of IDBI. The SIDBI has taken over the responsibility of administrating the Small Industries Development funds & the National Equity Fund.

It also facilitates the flow of credit at reasonable interest rates to the SME sectors.

It is the principal financial institution for the promotion, financing & development of industry in the small scale sector & to coordinate the functions of the institutions engaged in the promotion & financing or developing industry in the small scale sector & for matters connected therewith or incidental thereto.

The business domain of SIDBI consists of Micro, Small, & Medium Enterprises which contribute significantly to the national economy in terms of production, employment & export.

MSME sectors is an import pillar of the Indian economy as it contributes greatly to the growth of the Indian economy.

In addition, SIDBI's assistance also flows to the service sector including transport, health care, tourism sectors, etc. SIDBI among top 30 Development Bank of the World.

Industrial Credit and Investment Corporation of India (ICICI)

ICICI was set up in 1955 as a public limited company. It was to be a private sector development bank in so far as there was no participation by the Government in its share capital. It is a diversified long term financial institution and provides a comprehensive range of financial products and services including project and equipment financing, underwriting and direct subscription to capital issues, leasing, deferred credit, trusteeship, and custodial services, advisory services, and business consultancy

Objectives of ICICI

The main objective of the ICICI was to meet the needs of the industry for long term funds in the private sector. Other objectives include:

(a) To assist in the creation, expansion, and modernization of industrial enterprises in the private sector.
(b) To encourage and promote the participation of private capital, both internal and external, in such enterprises; and
(c) To encourage and promote private ownership of industrial investment and expansion of markets.

Functions of ICICI

1. It sanctions rupee loans for capital assets such as land, building, machinery, etc, for the long term, and foreign exchange loans for the import of machinery and equipment.
2. It guarantees loans from other private investment sources.
3. It subscribes to ordinary or preference capital and underwrites new issues of securities.
4. It renders consultancy services to the Indian industry in the form of managerial and technical advice.
5. It also undertakes financial services such as deferred credit, equipment leasing, installment sale, etc.

State Level Financial Institutions

Some financial institutions are working at the state level. The important state-level institutions are State Financial Corporations and State Industrial Development Corporations.

State Finance Corporations (SFCs)

The Govt. after independence realized the need of creating a financial corporation at the state level for catering to the needs of industrial entrepreneurs. As a result, the Govt of India after consultation with the State governments and the Reserve Bank of India introduced the State Finance Corporations bill in the Parliament in 1951. SFC Act came into existence with effect from August 1, 1952. The Act permitted the State Governments. To establish financial corporations for the purpose of promoting industrial development in their respective states by providing financial assistance to medium and small-scale industries.

Functions of State Finance Corporations

The main function of the SFCs is to provide loans to small and medium scale industries engaged in the manufacture, preservation, or processing of goods, mining, hotel industry, generation or distribution of power, transportation, fishing, assembling, repairing or packaging articles with the aid of power, etc. Other functions are as follows:

1. Granting loans or advances or subscribing to shares and debentures of the industrial undertaking repayable within twenty years.
2. Guaranteeing loans raised by the industrial concerns repayable within twenty years.
3. Underwriting of the shares, bonds, and debentures subject to their disposal in the market within seven years.
4. Guaranteeing deferred payments for the purchase of capital goods by industrial concerns within India.
5. Providing loans for setting up new industrial units as well as for expansion and modernization of the existing units.
6. Discounting the bills of small and medium scale industries.

Investment Institutions

The important investment institutions are:

1. Unit Trust of India (UTI)
2. Life Insurance Corporation of India (LIC)
3. General Insurance Corporation of India (GIC)
4. Life Insurance Corporation of India (LIC)

The Life Insurance Corporation of India was set up under the LIC Act, 1956 under which the life insurance was nationalized. As a result, the business of 243 insurance companies was taken over by LIC on 1-9-1956.

It is basically an investment institution, in as much as the funds of policyholders are invested and dispersed over different classes of securities, industries, and regions, to safeguard their maximum interest on a long-term basis. Life Insurance Corporation of India is required to invest not less than 75% of its funds in Central and State Government securities, the government guaranteed marketable securities, and in the socially-oriented sectors. At present, it is the largest institutional investor. It provides long-term finance to industries. Besides, it extends resource support to other term lending institutions by way of subscription to their shares and bonds and also by way of term loans.

Life Insurance Corporation of India which has entered into its 57th year has emerged as the world's largest insurance co. in terms of the number of policies covered. The Life Insurance Corporation of India's total coverage of policies including individual, group, and social schemes has crossed 11 crores.

Objectives of Life Insurance Corporation of India

The Life Insurance Corporation of India was established with the following objectives:

1. Spread life insurance widely and in particular to the rural areas, to the socially and economically backward classes with a view to reaching all insurable persons in the country and providing them adequate financial cover against death at a reasonable cost.
2. Maximisation of mobilization of people's savings for nation-building activities.
3. Provide complete security and promote efficient service to the policy-holders at economic premium rates.
4. Conduct business with utmost economy and with the full realization that the money belongs to the policyholders.
5. Act as trustees of the insured public in their individual and collective capacities.
6. Meet the various life insurance needs of the community that would arise in the changing social and economic environment.
7. Involve all people working in the corporation to the best of their capability in furthering the interest of the insured public by providing efficient service with courtesy.

Role and Functions of Life Insurance Corporation of India

The role and functions of Life Insurance Corporation of India may be summarised as below:

1. It collects the savings of the people through life policies and invests the fund in a variety of investments.

2. It invests the funds in profitable investments so as to get a good return. Hence the policyholders get benefits in the form of lower rates of premium and increased bonuses. In short, the Life Insurance Corporation of India is answerable to the policyholders.

3. It subscribes to the shares of companies and corporations. It is a major shareholder in a large number of blue-chip companies.

4. It provides direct loans to industries at a lower rate of interest. It is giving loans to industrial enterprises to the extent of 12% of its total commitment.

5. It provides refinancing activities through SFCs in different states and other industrial loan-giving institutions.

6. It has provided indirect support to industry through subscriptions to shares and bonds of financial institutions such as IDBI, IFCI, ICICI, SFCs, etc. at the time when they required initial capital. It also directly subscribed to the shares of Agricultural Refinance Corporation and SBI.

7. It gives loans to those projects which are important for national economic welfare. The socially-oriented projects such as electrification, sewage, and water channelizing are given priority by the Life Insurance Corporation of India.

8. It nominates directors on the boards of companies in which it makes its investments.

9. It gives housing loans at reasonable rates of interest.

10. It acts as a link between the saving and the investing process. It generates the savings of the small savers, middle-income groups, and the rich through several schemes.

11. Formerly LIC has played a major role in the Indian capital market. To stabilize the capital market it has underwritten capital issues. But recently it has moved to other avenues of financing. Now it has become very selective in its underwriting pattern.

2. General Insurance Corporation of India (GIC)

General insurance industry in India was nationalized and a government company known as General Insurance Corporation of India was formed by the central government in November 1972. General insurance companies have willingly catered to these increasing demands and have offered a plethora of insurance covers that almost cover anything under the sun. Any insurance other than 'Life Insurance' falls under the classification of General Insurance. It comprises of:-

a. Insurance of property against fire, theft, burglary, terrorism, natural disasters, etc.
b. Personal insurance such as Accident Policy, Health Insurance, and liability insurance covers legal liabilities.
c. Errors and Omissions Insurance for professionals, credit insurance, etc.
d. The policy covers such as coverage of machinery against breakdown or loss or damage during transit.
e. Policies that provide marine insurance cover goods in transit by sea, air, railways, waterways, and road and cover the hull of ships.
f. Insurance of motor vehicles against damages or accidents and theft.

All these above-mentioned form a major chunk of the non-life insurance business.

General insurance products and services are being offered as package policies offering a combination of the covers mentioned above in various permutations and combinations. There are package policies specially designed for householders, shopkeepers, industrialists, agriculturists, entrepreneurs, employees, and professionals such as doctors, engineers, chartered accountants, etc. Apart from standard covers, General insurance companies also offer customized or tailor-made policies based on the personal requirements of the customer.

Classification of Indian General Insurance Industry:

General Insurance is also known as Non-Life Insurance in India. There is a total of 16 General Insurance (Non-Life) Companies in India. These 16 General Insurance companies have been classified into two broad categories namely:

a) PSUs (Public Sector Undertakings)
b) Private Insurance Companies

These insurance companies are wholly owned by the Government of India.

There are totally 4 PSUs in India namely:-
- National Insurance Company Ltd
- Oriental Insurance Company Ltd
- The New India Assurance Company Ltd
- United India Insurance Company Ltd

b) Private Insurance Companies:-

There is a total of 12 private General Insurance companies in India namely:-

- Apollo DKV Health Insurance Ltd
- Bajaj Allianz General Insurance Co. Ltd
- Cholamandalam MS General Insurance Co. Ltd
- Future General Insurance Company Ltd
- HDFC Ergo General Insurance Co Ltd
- ICICI Lombard General Insurance Ltd
- Iffco Tokio General Insurance Pvt Ltd
- Reliance General Insurance Ltd
- Royal Sundaram General Insurance Co Ltd
- Star Health and Allied Insurance
- Tata AIG General Insurance Co Ltd
- Universal Sompo General Insurance Pvt Ltd

3. Unit Trust of India (UTI)

The Unit Trust of India was set up in February 1964 under the Unit Trust of India Act of 1963, in the public sector. It plays an important role in mobilizing the savings of investors through the sale of units and channelizing them into corporate investments. Over the years, it has introduced a variety of growth schemes to meet the needs of a diverse section of investors. After an amendment to its Act in April 1986, Unit Trust of India has started extending assistance to the corporate sector by way of term loans, bill rediscounting, equipment leasing, and hire purchase facilities.

The management of the trust is entrusted to the Board of Trustees. The chairman of the Board and 4 other trustees are appointed by the RBI. One trustee each is nominated by the LIC and the SBI, and 2 other trustees are elected by other subscribers to the capital of the trust.

Unit Trust of India has recently set up an Asset Management Company to bring some of its mutual fund schemes under its purview. It also engaged in the investment banking business, stockbroking, consultancy, etc.

Sanctions up to March 1993, amounted to Rs. 7520.6 crores. One of the striking features of purpose-wise UTI sanctions reveals that working capital requirements of industrial concerns have received the maximum attention (over 50-55%). Similarly, the private sector accounts for the highest share in Unit Trust of India sanctions (about 67%) followed by the public sector (32%). Unit Trust of India is the first unit trust in the public sector in the world.

Objectives of Unit Trust of India:

The basic objective of the establishment of Unit Trust of India was to encourage investment and participation in the income, profits, and gains accruing to the corporation from the acquisition, holding, management, and dispersal of securities. The other objectives are as follows:

1. To stimulate and pool the savings of the middle and low-income groups.
2. To enable unitholders to share the benefits and prosperity of the rapidly growing industrialization in the country.
3. To sell units among as many investors as possible.
4. To invest the money raised from the sale of units and its own capital in corporate and industrial securities.
5. To pay dividends to the unitholders.

Advantages of Units of Unit Trust of India:

1. Investment in units is safe.
2. Units are highly liquid.
3. Unit holders get a steady and decent income in the form of dividends.
4. Dividend on the unit is exempt from income tax up to a certain amount.
5. Wealth taxpayers get a benefit.

Disadvantages of Units of Unit Trust of India:

1. Unitholders have no right to attend the annual general meeting of the Unit Trust of India.
2. Unitholders are not entitled to certain concessions which are offered to shareholders by certain companies.
3. Only 90% of the income of the trust can be distributed among the unitholders.

Export-Import Bank of India (EXIM BANK)

Export-Import Bank of India is the premier export finance institution of the country. It commenced operations in 1982 under the Export-Import Bank of India Act 1981. Govt of India launched the institution with a mandate to not just enhance export from India, but also to integrate the country's foreign trade & investment with the overall economic growth.

Like other export credit agencies in the world, Exim bank of India has evolved into an institution that plays a major role in partnering Indian industries, particularly the small & medium Enterprises through a wide range of products & services offered at all stages of the business cycle, starting from import of technology & export product development to export production, export marketing, pre-shipment & overseas investments.

The objective of EXIM:

The main objective is to provide financial assistance to exporters & importers, and for functioning as the principal financial institution for coordinating the working of institutions

engaged in financing export & import of goods & services with a view to promoting the country's international trade.

National Housing Bank

NHB was set up on July 9, 1988, under the National Housing Bank Act 1987. NHB is wholly owned by RBI which contributed the entire paid-up capital. The head office of NHB is in New Delhi. The vision of NHB is ***"promoting inclusive expansion with stability in the housing finance market".***

NHB has been established to achieve the following objective:

- To promote a sound, healthy, viable & cost-effective housing finance system to cater to all segments of the population & to integrate the housing finance system with the overall financial system.
- To promote a network of dedicated housing finance institutions to adequately serve various regions & different income groups.
- To augment resources for the sector & channel them for housing.
- To make housing credit more affordable.
- To regulate the activities of housing finance companies based on regulatory & supervisory authority derived under the act.
- To encourage augmentation of supply of buildable land & also building materials for housing & to upgrade the housing stock in the country.
- To encourage public agencies to emerge as facilitators & suppliers of serviced land, for housing.