The Committee

Appendix A

The members of the Committee and its Terms of Reference are as follows:

Members:

(i) Mr. Percy S. Mistry, Chairman, Oxford International Group, Chairman (resigned as Chairman of HPEC w.e.f. 07/02/2007)

(ii) Mr. M. Balachandran, CMD, Bank of India

(iii) Mr. Aditya Puri, MD, HDFC Bank

(iv) Mr. K.V. Kamath, MD& CEO, ICICI Bank

(v) Mr. C.B. Bhave, CMD, NSDL

(vi) Mr. Ravi Narain, MD, National Stock Exchange

(vii) Mr. Bharat Doshi, CFO, Mahindra & Mahindra

(viii) Dr. P.J. Nayak, CMD, UTI Bank

(ix) Shri T.T. Srinivasaraghavan, MD, Sundaram Finance

(x) Shri Mohan Raj, MD, LIC Mutual Fund

(xi) Mr. Nimesh Kampani-Chairman, JM Morgan Stanley

(xii) Mr. O. P. Bhatt, Chairman, State Bank of India (Mr. A.K. Purwar, Chairman, SBI was a member of HPEC till 31/05/2006 and Mr. Bhatt, Chairman, SBI from 01/07/2006 till the submission of the report.)

(xiii) Ms. Usha Narayanan, ED, Securities and Exchange Board of India

(xiv) Mr. Subodh Kumar, Principal Secretary (Finance), Government of Maharashtra (Mr. O.P. Gahrotra, Additional Chief Secretary (Finance) was a member of HPEC till 30/09/2006 and Mr. Subodh Kumar, Principal Secretary (Finance) from 01/10/2006 till the submission of the report.)

(xv) Dr. K P Krishnan, Convenor-Joint Secretary (Capital Markets), DEA, GoI.

(xvi) Representatives of RBI participated in some of the meetings as invitees.

This report reflects their personal expertise and judgement about the best strategy for India in modernising finance and achieving an IFC; it does not reflect the views of the organisations they represent.

Terms of Reference of the Commitee

In the recent decade, India has made significant strides in the financial sector. Some of the important developments are strengthening of banks, de-regulation of interest rates and sector competition in the banking system, development of the government securities market, and infrastructure for trading, particularly on the equity market, with the move to electronic trading, novation at the clearing corporation, T + 2 rolling settlement, dematerialised settlement, demutualisation of stock exchanges and derivatives trading. This raises questions about how Mumbai can play a bigger role in the global market for financial services. Our current policy on capital account convertibility constrains the emergence of Mumbai as a financial centre. There is, however, a need to look ahead and prepare for the emergent role of Mumbai as a regional/international financial centre, so that our institutions get integrated with global institutions and economies in terms of provision of financial services.

The committee will look into and make recommendations on the following issues:

(i) Review the functioning of and developments related to international/offshore financial centres and current trends in regard to establishment of new centres;

(ii) Identify the characteristics of a regional financial centre (RFC), and the current state of Mumbai as a national financial centre;

(iii) Review the existing legal, regulatory, taxation and accounting framework related to financial services in India, identify the extant policy and regulatory restrictions constraining the emergence of Mumbai as an RFC and the changes therein necessary for enabling and facilitating the function of such a centre;

(iv) Identify the measures that would need to be adopted for Mumbai to transform itself from being a national financial centre to an RFC in each of the financial sub-sectors *e.g.*, the equity, bond, forex and commodity markets;

(v) Examine the nature of financial services that could be permitted to be undertaken in the RFC in Mumbai, the desirable sequencing of permitting such services and the appropriate regulatory framework therefore, in each of the financial sub-sectors aforesaid, including the allocation of regulatory responsibilities amongst different financial sector regulators, consistent with the progress made in achieving full capital account convertibility;

(vi) Make an assessment of the risks and benefits inherent in such a centre and the safeguards that would need to be built into the policy framework, alongwith the scope and structure desirable for such a centre;

(vii) Identify and evaluate the considerations that should govern the development of the institutional framework for such a centre in India in the light of international experience, issues in the management of the capital account in India and international financial integration of the Indian economy consistent with the WTO framework; and

In light of the above, recommend a phased action plan, including specific actions required by different agencies covering institutions, infrastructure, legal, taxation issues etc. for the development of Mumbai as an RFC.

Team of consultants

The committee was supported by a team of consultants comprising Ritu Anand (SBI), Saugata Bhattacharya (UTI Bank), Kshama Fernandes (Goa Institute of Management), S. Ravindranath (Bank of India), and Ajay Shah.

Comparing existing IFCs against Mumbai

Appendix B

Attributes, Characteristics and Capabilities of an IFC : (*Scale of 0–10 with 0 = worst 10 = best*)	London	New York	Tokyo	Singapore	Frankfurt	Mumbai
A. Demand Factors for IFS						
A1. National (Domestic) demand for IFS	10	10	10	4	10	10
A2. Demand for IFS from Regional clients	10	10	3	9	7	1
A3. Demand for IFS from Global clients	10	10	3	5	3	0
B. Supply Factors for IFS: Markets, Products & Services						
B1. Full Array of international banking services for corporates and individuals	9	9	9	10	6	5
B2. Full Array of international capital markets, products and services	10	10	7	8	5	3
B3. Full Array of risk management services	10	10	5	7	6	2
B4. Full Array of insurance and reinsurance services	10	10	7	5	8	1
B5. Full Array of commodities markets, trading and hedging services	9	9	5	5	4	1
B6. Full Array of business support services for IFS (accounting, legal, IT support)	10	10	8	10	8	5
C. Institution/Market Endowments enabling range of IFS product/service offerings:						
C1. Range, width, depth of international commercial banks represented in the IFC	10	7	5	8	6	2
C2. Range of global, regional and national investment banks represented in the IFC	10	10	8	9	7	2
C3. Range of global, regional and national insurance companies represented	10	9	8	6	8	2
C4. Existence of wide and deep reinsurance markets	10	9	8	6	9	1
C5. Existence of global, regional, national equity markets (i.e. exchanges & support)	10	10	9	8	6	4
C6. Existence of wide and deep bond markets for government, corporate, other bonds	10	10	9	5	9	1
C7. Existence of wide, deep and liquid derivatives markets for:						
Equities and indexes	10	10	6	7	6	5
Interest rates	10	10	8	7	7	1
Currencies	10	10	7	8	8	1
Commodities	10	8	7	5	8	3
C8. Innovative Abilities of Institutions and Markets	10	10	5	6	4	5
D. Services Offered						
D1. Fund Raising, Wholesale and Corporate Banking	10	10	8	7	7	5
D2. Asset Management	10	10	8	9	6	4
D3. Private Banking & Wealth Management	10	7	5	7	5	2
D4. Global Tax Optimisation & Management	6	5	3	8	4	1
D5. Corporate Treasury Management	10	10	9	8	8	4
D6. Risk Management	10	10	7	7	6	2
D7. Mergers & Acquisitions: (national, regional, global)	10	10	6	5	5	3
D8. Financial Engineering for Large Complex Project and PPP Financing	10	10	8	7	6	3
D9. Leasing & Structured Financing of Mobile Capital Assets (ships, planes etc.)	10	10	9	9	10	2

	Attributes, Characteristics and Capabilities of an IFC : (*Scale of 0–10 with 0 = worst 10 = best*)	London	New York	Tokyo	Singapore	Frankfurt	Mumbai
E.	**Quality & Impact of Financial System Regulatory Regime**	10	7	6	7	5	3
E1.	Ensuring Systemic Stability	10	9	8	8	8	7
E2.	Protecting Integrity & Soundness of Financial Institutions	9	9	9	9	8	6
E3.	Capacity to Cope with Market & Institutional failures	10	9	8	8	7	7
E4.	Sound risk based management at all levels: systemic, market, institutional	10	10	8	8	8	6
E5.	Effective (vs. intended but ineffectual) Consumer Protection	8	7	7	8	9	5
E6.	Encouraging full and effective competition across institutions/segments	10	6	5	7	5	2
E7.	Ensuring level playing field for all players in all market segments	9	7	5	7	6	2
E8.	Extent of Protectionism embedded in regulatory system	9	6	5	5	4	1
E9.	Avoidance of conflicts-of-interest	8	7	5	6	5	1
E10.	Impact on Financial Innovation	10	10	5	5	4	1
E11.	Extent of Intrusiveness and micro-management of markets/institutions	10	8	7	6	5	1
E12.	Principles-based, open, market-friendly and competition inducing	10	7	7	6	6	1
E13.	Conducive to efficient and effective resource mobilisation and allocation	8	7	6	7	6	2
F.	**Quality, Efficiency, Effectiveness and Supportiveness of Judicial/Legal Systems**						
F1.	Knowledge capacity in dealing with complex financial contracts, instruments, etc.	8	9	6	6	5	
F2.	Efficiency of judicial/legal system (i.e. time for dispute resolution)	7	8	7	9	6	
F3.	Effectiveness of judicial/legal systems – enforcement and rule of law	7	8	7	8	6	
F4.	Fairness, Impartiality, Credibility, Lack of Corruption in civil justice system	7	7	9	10	8	
F5.	Human & Institutional Capacity and Quality of the Judicial/Legal System	7	8	7	8	7	
F6.	Adherence to global benchmarks and standards of best practice	8	8	6	7	6	
F7.	Use of national law in national, regional and global contracts	8	9	3	5	4	
G.	**Governance Issues Affecting Operations/Credibility of the IFC**						
G1.	Quality and Credibility of National Governance (Legislature & Government)	7	6	7	10	6	3
G2.	Quality and Credibility of State/Provincial Governance	8	9	8	10	8	1
G3.	Quality and Credibility of Local/Municipal Governance	8	8	9	10	8	0
G4.	Influence of Politics in diminishing Governance Quality:						
	National/Federal 6	6	8	10	8	2	
	State/Provincial	6	8	8	10	7	1
	Local/Municipal	8	8	8	10	7	0
G5.	Quality, Capacity, Efficiency, Effectiveness of Administration:						
	National	6	7	8	10	7	4
	State	6	8	8	10	7	2
	Municipal	8	9	9	10	7	1
G6.	Role of Checks & Balances (NGO oversight, media freedom, civic action etc.)	8	9	5	2	7	2

	Attributes, Characteristics and Capabilities of an IFC : (*Scale of 0–10 with 0 = worst 10 = best*)	London	New York	Tokyo	Singapore	Frankfurt	Mumbai
H.	**Quality & Capacity of Business Support Services to Sustain an IFC**						
	H1. Quality, reputation and presence of International Accounting/Audit Firms	9	9	8	9	9	6
	H2. Quality, reputation and presence of International Law Firms	9	10	6	7	6	2
	H3. Quality, reputation and presence of International Business Consulting Firms	10	10	8	9	7	4
	H4. Quality and competitiveness of IT, BPO, KPO support systems	6	6	4	5	4	9
J.	**Human Capital Support for the IFS Industry**						
	J1. Quality, availability and cost of Finance Industry professionals:						
	Strategic/Exec10	10	5	6	4	3	
	Management (all functions)	7	8	5	6	4	4
	Trading & Dealing	9	9	6	8	6	4
	Financial Analysis & Research	7	9	5	6	5	8
	Compliance Specialists	8	7	6	9	8	4
	Back-Office Functions/Support	6	7	4	5	4	9
	J2. Presence/Quality of Post-Graduate Teaching/Research Institutions in Finance	6	10	4	3	3	2
	J3. Local Pool/Network of globally experienced finance professionals	10	8	4	7	4	2
	J4. Local presence of Global HR Recruitment/Consulting/Training Firms	10	10	6	8	5	2
	J5. Ease of entry, exit and overall mobility of global finance professionals at all levels	8	7	3	7	4	2
K.	**Quality of Physical & Social Infrastructure & Living Environment**						
	K1. Quality/Availability/Cost of Basic Core infrastructure:						
	Power	9	9	10	10	10	4
	Water	9	9	10	10	10	4
	Telecommunications	9	10	10	10	9	6
	Transport	5	6	7	8	8	2
	Residential Space	7	5	5	7	8	3
	Office/Commercial	9	9	10	10	10	3
	K2. Leisure, Entertainment, Global Cultural, Recreational and Food Facilities	10	10	3	4	6	2
	K3. Use of English as the default international language at work and at leisure	10	10	2	9	5	7
	K4. Use of English as the default international language for financial contracts	10	10	5	10	6	9
	K5. Availability, Accessibility, Cost of healthcare and education (global standards)	5	5	6	8	8	3
	K6. Availability, Accessibility, Cost of personal and domestic services	3	3	1	5	1	9
L.	**Capital Account Convertibility**	10	10	10	10	10	3
M.	**Overall Score/Rating**	**9.5**	**9**	**6**	**7.5**	**5.5**	**2.5**

Attributes, Characteristics and Capabilities of an IFC : (*Scale of 0–10 with 0 = worst 10 = best*)	London	New York	Tokyo	Singapore	Frankfurt	Mumbai
N. Taxation Issues as they affect the attractiveness of an IFC						
N1. Taxation of Resident Individuals working in the IFC	5	4	3	5	2	5
N2. Taxation of Non-resident Individuals working in an IFC	7	5	5	6	3	6
N3. Taxation of Resident Companies	4	4	3	5	2	5
N4. Taxation of Non-resident companies	7	5	5	8	4	5
N5. Withholding Taxes levied on financial instruments/transactions.	4	3	3	5	3	5
N6. Transactions Taxes on Financial Transactions – Domestic	6	7	4	7	4	1
N7. Transactions Taxes on Financial Transactions – IFS	7	6	6	8	5	?
N8. Provisions for IBC or GBC licensing (*e.g.*, Delaware type)	6	8	2	8	2	0
N9. Taxation of IBC/GBC companies	6	6	5	8	2	0
N10. Overall Taxation Environment	5	5	4	7	2	5
N11. Complexity of Tax Laws, Codes, Rules, Regulations	4	3	4	7	3	1
N12. Effectiveness, Efficiency, Fairness and Corruption in Tax Administration	9	7	8	9	9	3

Comparing emerging IFCs against Mumbai

Appendix C

Attributes, Characteristics and Capabilities of an IFC : (*Scale of 0–10 with 0 = worst* 10 = *best*)	Mumbai	Hong Kong	Labuan	Seoul	Sydney	Dubai
A. Demand Factors for IFS						
A1. National (Domestic) demand for IFS	10	4	2	7	6	2
A2. Demand for IFS from Regional clients	1	7	5	2	3	9
A3. Demand for IFS from Global clients	0	2	2	2	3	5
B. Supply Factors for IFS: Markets, Products & Services						
B1. Full Array of international banking services for corporates and individuals	5	7	4	6	7	6
B2. Full Array of international capital markets, products and services	3	6	2	5	7	5
B3. Full Array of risk management services	2	5	2	5	6	5
B4. Full Array of insurance and reinsurance services	1	5	0	3	5	2
B5. Full Array of commodities markets, trading and hedging services	1	6	2	5	6	2
B6. Full Array of business support services for IFS (accounting, legal, IT support)	5	8	5	5	8	6
C. Institution/Market Endowments enabling range of IFS product/service offerings:						
C1. Range, width, depth of international commercial banks represented in the IFC	2	7	5	5	7	4
C2. Range of global, regional and national investment banks represented in the IFC	2	6	1	3	6	4
C3. Range of global, regional and national insurance companies represented	2	6	1	5	6	3
C4. Existence of wide and deep reinsurance markets	1	3	0	3	4	1
C5. Existence of global, regional, national equity markets (*i.e.*, exchanges & support)	4	5	2	4	5	2
C6. Existence of wide and deep bond markets for government, corporate, other bonds	1	1	0	4	7	0
C7. Existence of wide, deep and liquid derivatives markets for:						
Equities and indexes 5	5	1	5	6	2	
Interest rates	1	3	0	4	7	1
Currencies	1	7	2	6	8	5
Commodities	3	5	0	4	6	3
C8. Innovative Abilities of Institutions and Markets	5	5	1	4	7	5
D. Services Offered						
D1. Fund Raising, Wholesale and Corporate Banking	5	7	3	7	7	5
D2. Asset Management	4	9	4	6	6	8
D3. Private Banking & Wealth Management	2	9	6	4	5	9
D4. Global Tax Optimisation & Management	1	9	7	4	4	9
D5. Corporate Treasury Management	4	7	2	7	8	7
D6. Risk Management	2	6	1	4	6	3
D7. Mergers & Acquisitions: (national, regional, global)	3	5	0	5	5	4
D8. Financial Engineering for Large Complex Project and PPP Financing	3	5	1	7	6	5
D9. Leasing & Structured Financing of Mobile Capital Assets (ships, planes *etc.*)	2	9	5	5	5	7

Attributes, Characteristics and Capabilities of an IFC : (*Scale of 0–10 with 0 = <u>worst</u> 10 = <u>best</u>*)	Mumbai	Hong Kong	Labuan	Seoul	Sydney	Dubai
E. Quality & Impact of Financial System Regulatory Regime	**3**	**8**	**4**	**6**	**7**	**7**
E1. Ensuring Systemic Stability	7	7	3	7	8	5
E2. Protecting Integrity & Soundness of Financial Institutions	6	7	5	7	8	6
E3. Capacity to Cope with Market & Institutional failures	7	9	3	7	8	6
E4. Sound risk based management at all levels: systemic, market, institutional	6	7	5	7	8	5
E5. Effective (vs. intended but ineffectual) Consumer Protection	5	6	4	7	8	5
E6. Encouraging full and effective competition across institutions/segments	2	8	5	7	8	9
E7. Ensuring level playing field for all players in all market segments	2	8	4	5	6	8
E8. Extent of Protectionism embedded in regulatory system	1	7	5	5	7	8
E9. Avoidance of conflicts-of-interest	1	6	4	5	8	4
E10. Impact on Financial Innovation	1	7	2	5	7	5
E11. Extent of Intrusiveness and micro-management of markets/institutions	1	8	5	5	7	5
E12. Principles-based, open, market-friendly and competition inducing	1	7	2	5	6	8
E13. Conducive to efficient and effective resource mobilisation and allocation	2	7	3	6	6	5
F. Quality, Efficiency, Effectiveness and Supportiveness of Judicial/Legal Systems						
F1. Knowledge capacity in dealing with complex financial contracts, instruments, *etc.*		8	4	5	7	6
F2. Efficiency of judicial/legal system (*i.e.*, time for dispute resolution)		8	5	6	7	10
F3. Effectiveness of judicial/legal systems – enforcement and rule of law		7	5	6	8	5
F4. Fairness, Impartiality, Credibility, Lack of Corruption in civil justice system		7	5	6	9	5
F5. Human & Institutional Capacity and Quality of the Judicial/Legal System		6	5	6	8	5
F6. Adherence to global benchmarks and standards of best practice		8	6	7	8	7
F7. Use of national vs. UK/US law in national, regional and global contracts		6	6	5	6	9
G. Governance Issues Affecting Operations/Credibility of the IFC						
G1. Quality and Credibility of National Governance (Legislature & Government)	3	3	6	6	7	7
G2. Quality and Credibility of State/Provincial Governance	1	5	6	7	8	7
G3. Quality and Credibility of Local/Municipal Governance	0	6	6	7	8	9
G4. Influence of Politics in diminishing Governance Quality:						
National/Federal	2	5	5	5	8	8
State/Provincial	1	6	5	5	7	8
Local/Municipal	0	7	6	7	8	10
G5. Quality, Capacity, Efficiency, Effectiveness of Administration:						
National	4	5	5	6	8	8
State	2	6	5	6	8	8
Municipal	1	7	6	7	8	8
G6. Role of Checks & Balances (NGO oversight, media freedom, civic action *etc.*)	2	4	3	4	6	0

Attributes, Characteristics and Capabilities of an IFC : (*Scale of 0–10 with 0 = worst 10 = best*)	Mumbai	Hong Kong	Labuan	Seoul	Sydney	Dubai
H. Quality & Capacity of Business Support Services to Sustain an IFC						
H1. Quality, reputation and presence of International Accounting/Audit Firms	6	8	5	7	9	6
H2. Quality, reputation and presence of International Law Firms	2	8	5	5	8	5
H3. Quality, reputation and presence of International Business Consulting Firms	4	7	4	6	8	6
H4. Quality and competitiveness of IT, BPO, KPO support systems	9	5	3	5	5	6
J. Human Capital Support for the IFS Industry						
J1. Quality, availability and cost of Finance Industry professionals:						
Strategic/Executive/Conceptual	3	6	4	5	7	6
Management (all functions)	4	7	5	6	7	6
Trading & Dealing	4	7	3	6	7	5
Financial Analysis & Research	8	7	3	6	7	6
Compliance Specialists	4	5	3	6	8	6
Back-Office Functions/Support	9	7	6	6	4	6
J2. Presence/Quality of Post-Graduate Teaching/Research Institutions in Finance	2	3	0	3	5	0
J3. Local Pool/Network of globally experienced finance professionals	2	5	2	5	7	5
J4. Local presence of Global HR Recruitment/Consulting/Training Firms	2	5	3	5	7	5
J5. Ease of entry, exit and overall mobility of global finance professionals at all levels	2	6	4	3	6	8
K. Quality of Physical & Social Infrastructure & Living Environment						
K1. Quality/Availability/Cost of Basic Core infrastructure:						
Power	9	9	10	10	10	
Water	4	9	9	10	10	8
Telecommunications	6	10	10	10	10	10
Transport	2	6	8	8	8	5
Residential Space	3	7	8	8	8	7
Office/Commercial	3	9	8	9	9	10
K2. Global Leisure, Entertainment, Cultural, Recreational and Food Facilities	2	4	3	3	7	5
K3. Use of English as the default international language at work and at leisure	7	5	5	3	10	6
K4. Use of English as the default international language for financial contracts	9	10	10	5	10	10
K5. Availability, Accessibility, Cost of healthcare and education (global standards)	3	6	7	7	8	6
K6. Availability, Accessibility, Cost of personal and domestic services	9	6	7	4	2	9
L. Capital Account Convertibility	3	10	7	10	10	10
M. Overall Score/Rating	**2.5**	**6.5**	**3**	**5**	**7**	**6**

Attributes, Characteristics and Capabilities of an IFC : (Scale of 0–10 with 0 = worst 10 = best)	Mumbai	Hong Kong	Labuan	Seoul	Sydney	Dubai
N. Taxation Issues as they affect the attractiveness of an IFC						
N1. Taxation of Resident Individuals working in the IFC	5	8	5	4	4	10
N2. Taxation of Non-resident Individuals working in an IFC	6	10	10	7	7	10
N3. Taxation of Resident Companies	5	8	6	5	4	10
N4. Taxation of Non-resident companies	5	10	9	8	5	10
N5. Withholding Taxes levied on financial instruments/transactions.	5	10	9	5	5	10
N6. Transactions Taxes on Financial Transactions – Domestic	1	10	5	5	2	10
N7. Transactions Taxes on Financial Transactions – IFS	?	10	9	8	6	10
N8. Provisions for IBC or GBC licensing (*e.g.*, Delaware type)	0	9	9	5	3	10
N9. Taxation of IBC/GBC companies	0	9	8	6	5	10
N10. Overall Taxation Environment	5	8	7	6	5	10
N11. Complexity of Tax Laws, Codes, Rules, Regulations	1	8	7	5	4	9
N12. Overall Effectiveness, Efficiency, Fairness and Corruption in Tax Revenue Administration	2	8	7	6	8	9

Chronology of events associated with the effort by Benchmark Asset Management Company (BAMC) to start an Exchange Traded Fund (ETF) on Gold

Appendix D

- *2 May 2002* Draft offer document of Gold ETF filed by BAMC with SEBI.
- *3 May 2002* Copy of offer document sent to RBI for information.
- *30 May 2002* SEBI raised first list of queries, and asked BAMC to incorporate the features of Gold Deposit Scheme in the offer document. Meanwhile, NSE informally advised BAMC to seek specific approval of RBI.
- *14 June 2002* BAMC wrote to RBI seeking clarification on Gold Deposit Scheme for inclusion in offer document.
- *27 June 2002* RBI asked for a detailed mechanism including investment and settlement process envisaged under Gold ETF.
- *1 July 2002* A detailed note was submitted to RBI.
- *July to September, 2002* Several meetings took place between BAMC, RBI and SEBI to sort out issues relating to Gold ETF. RBI DBOD asked for comments from RBI DEIO.
- *9 September 2002* Fresh offer document was filed with SEBI incorporating observations made by SEBI vide its letter dated May 30, 2002. However RBI had still not replied.
- *11 Sep 2002* Presentation made to FMC stating that the Scheme would not amount to forward trading in gold.
- *3 October 2002* BAMC again wrote to RBI explaining the mechanism and how the Scheme will help meet objectives of Gold Deposit Scheme.
- *17 October 2002* RBI replied to BAMC stating that primary gold cannot be deposited by Authorised Participants under Gold deposit scheme. It also advised BAMC to satisfy FMC before launching the product.
- *25 October 2002* BAMC informed RBI that it planned to launch the Scheme under existing Gold Deposit Scheme guidelines and that it will accept gold from APs as per existing Gold Deposit guidelines.
- *1 November 2002* BAMC responded to a SEBI request with information about the proposed method for valuation of CDs issued by banks under Gold Deposit Scheme.
- *26 November 2002* FMC informed BAMC and NSE that the Scheme is violative of the Forward Contracts (Regulation) Act.
- *2 December 2002* SEBI called a meeting of bankers interested in Gold ETF. ICICI Bank and Bank of Nova Scotia

attended the meeting in SEBI's office and reaffirmed their commitment to enabling the Gold ETF.

- *2nd week December 2002* SEBI wrote to RBI asking its views on Gold ETF and whether CDs issued under Gold Deposit scheme are money market instruments.
- *3 January 2003* BAMC obtained a legal opinion from Dave, Girish & Co. stating that Gold ETF does not amount to spot trading in gold and the Scheme is not violative of Forward Contract Regulations. BAMC forwarded this opinion to SEBI, RBI and NSE. Subsequently, MOF lifted the ban on forward trading in gold, so in any case, FMC's objection became irrelevant.
- *1st week February 2003* RBI wrote to SEBI stating that SEBI should decide whether a Gold CD was a "money market instrument", and that the Gold ETF structure had not been envisaged by RBI when the Gold Deposit Scheme was launched.
- *24 February 2003* BAMC modified the Scheme stating that deposit of gold under Gold Deposit scheme will not be restricted to APs and will be open to all. Moerever any party would be able to deposit gold in a form acceptable under Gold Deposit Scheme.
- *2nd week April 2003* SEBI again wrote to RBI asking whether this modified Scheme is acceptable to RBI.
- *1st week May 2003* RBI DBOD forwarded this letter to RBI DEIO for their comments and action.
- *4th week August 2003* Presentation made by BAMC to JS (CM), Ministry of Finance.
- *4th week September 2003* Presentation made by BAMC to RBI DBOD and DEIO.
- *4th week October 2003* Presentation made by BAMC to Member, SEBI.
- *2nd week December 2003* Presentation made by BAMC to Monetary Policy Department of RBI. MPD was to prepare a note and forward the same to DEIO/DBOD.
- *All of 2004* Silence.
- *28 February 2005* Finance Minister announced in his budget speech that gold ETFs would come about in India.
- *March–April 2005* SEBI constituted a committee to write down rules about Gold ETFs.
- *December 2005* SEBI Board approves amendment to SEBI Act for permitting launch of gold ETFs.
- *April 2006* SEBI announced valuation guidelines for gold ETFs.
- *May 2006* BAMC filed fresh offer document with SEBI which was consistent with the committee report.

Activities of various financial firms in the areas of operation at an IFC: Wall chart

Appendix E

In Chapter 2, we looked at the various activities that take place in an IFC. We discussed in details the products and services that IFCs like London and New York provide. If the goal is to make Mumbai an IFC in the true sense, we would need to put in place the infrastructure, both institutional and regulatory that would enable entities to engage in providing and availing these products and services.

In the process of creation of an IFC, the adequacy of regulatory infrastructure needs to be evaluated, to get a sense of what needs to be put in place for progressing towards being a full-fledged IFC. We study the regulatory impediments that exist and prevent banks, asset managers and securities exchanges from offering/availing these products and services in the area of fund raising, asset management, personal wealth management, global tax management, risk management, financial markets, mergers and acquisitions, leasing/structured finance, project finance, PPP and insurance and reinsurance.

1. Fund raising

An IFC provides a platform for entities to raise large amounts of funds on a global scale. Funds could be raised via equity, debt or composite structures across various maturity and currency spectra. We look at the impediments on fund raising by various entitites in India.

1.1. Fund raising and commercial banks

Commercial banks are permitted to do the following:

1. Raise equity in India or abroad for their own capital base. However PSU banks have problems since GOI does not allow their own share to drop below 51%. Raising equity abroad is a problem because of government restriction on foreign ownership and on the voting rights of foreigners.
2. Give INR lending to specialised finance companies involved in the equity market such as investment banks, exchanges, securities firms, asset managers and hedge funds subject to prudent limits. However these banks are not permitted to lend to the above entities in foreign currency. Nor are they allowed to invest by way of equity into these specialised finance firms.

However they face various regulatory impediments in terms of providing products and services in fund raising:

1. Inability to provide equity funding to corporate customers in India or abroad.
2. Inability to invest INR or foreign equity to specialised finance companies involved in the equity market such as investment banks, exchanges, securities firms, asset managers and hedge funds.
3. Inability to trade on domestic and foreign equity markets.
4. Inability to setup hedge funds or any type of money management firms.
5. Lack of identical policy/regulatory treatment for "local" versus "foreign" firms.

6. Lack of identical policy/regulatory treatment for lending through loans versus corporate bonds.
7. Lack of identical policy/regulatory treatment for a domestic borrower as opposed to a foreign borrower, across currencies of denomination of lending.
8. Absence of a sound legal framework governing bankruptcy, with a well–developed "bankruptcy code" with adequate supporting institutions.
9. Absence of a legal framework which makes it possible to exactly codify the seniority associated with a given loan/bond.
10. Absence of regulations which enable equity capital requirements for credit portfolio to be based on the portfolio risk after all credit derivatives and other derivatives are taken into account.
11. Lack of access to liquid and risk-manageable INR and foreign loan and bond markets.
12. Absence of prudent limits for the INR and foreign debt financing based on credit risk of both borrower and lender.
13. Inability to engage in syndication, securitisation, cash-flow stripping, trading in loans, between a full range of finance companies and third parties.
14. Inability to provide holistic INR/forex financial structure to corporate clients comprising packages of equity, debt, convertibles, options, swaptions, caps, collars.
15. Inability to finance convertible instruments in INR or forex, either up-front or in "workouts".
16. Inability to exercise conversion options in INR or forex (issues of price, period, post-conversion ownership structure, ownership concentration, foreign ownership).
17. Absence of legal/regulatory framework that permits the handling of workouts that may involve debt conversion into various kinds of equity or quasi-equity.

1.2. Fund raising and investment banks

Investment banks in India are greatly disadvantaged due to restrictions and lack of regulatory clarity about fund raising activities. To make investment banks in India globally competitive in terms of debt and equity funding, regulations need to enable them to do the following:

1. Raise equity funding for themselves in India or abroad.
2. Provide equity funding to firms, INR or forex.
3. Setup hedge funds.
4. INR or forex equity provision for other providers of equity (securities, asset managers, insurance companies, hedge funds).
5. Trade in INR and forex equity markets either onshore or offshore.
6. Raise INR/forex debt resources for own use, for providing debt, for underwriting corporate bonds, or buying corporate bonds on the primary or secondary market.
7. Receive identical treatment between banks and IBs in terms of participation on the government bonds markets onshore and offshore.
8. Utilise securitisation and derivatives to perform debt transformation services for maturity, duration, coupon, currency exposure, credit enhancement.
9. Take up opportunities in distressed debt and workout funds.
10. Receive identical treatment for local and foreign firms in the distressed debt workout/reconstruction market.

In terms of providing composite funding structures, investment banks in India face the same issues as the commercial banks.

1.3. Fund raising and private banks

In order to provide a range of products and services in private banking, the following needs to be put in place in terms of legal/regulatory issues:

1. Removal of constraints against banks or specialist "private bankers" offering private banking services.
2. Enabling commercial banks to setup a private banking division, subsidiary or affiate.
3. Setting up regulatory infrastructure that lays down guidelines in terms of client solicitation, invitation for PWM services, global assets, global customers including local and NRI customers.

1.4. Fund raising and securities markets

In order to permit brokerage/security firms in India to tap the global market and make them competitive in fund raising activities, the regulatory/legal framework must provide and support the following which is currently not permitted:

1. Providing equity funding in INR/forex to customer firms.
2. Setting up of hedge funds.
3. INR/forex resource raising for banks, exchanges, money managers, hedge funds.
4. Investments in INR or forex in other providers of equity — *i.e.*, asset managers, insurance companies, hedge funds, mutual funds.
5. Trading in local and offshore equity markets.
6. Identical treatment of brokerage firms versus investment banks when it comes to funding equity directly or indirectly in INR or forex.
7. Raising INR/forex debt resources, for loans, underwriting corporate bonds, or purchase of bonds on the primary or secondary market.
8. Level playing field between banks and securities firms on the government bond market, on collateralised debt financing, and on recovery procedures in the event of default.
9. Offering transformation services based on interest rate derivatives, credit derivatives or securitisaion.
10. Level playing field for foreign/local firms, neutral treatment of local assets versus foreign assets.
11. Raising/providing funding using any debt or equity composite structure.

2. Asset management

The bulk of asset management is transacted through the world's major IFCs. Asset management includes a combination of front and back office functions. We look at two forms of asset management and the legal/regulatory impediments that exist from the point of view of banks, asset managers and brokers/security firms — discretionary asset management (assets are managed purely by the asset manager and the client has no involvement other than a broad view about risk exposure) and non-discretionary asset management (assets are managed with partial or full instructions from client).

2.1. Asset management and banks

Commercial banks have very strict restrictions and very little scope to engage in activities as far as asset management is concerned. To enable banks to compete in the IFS space, the following needs to be enabled:

1. Offering discretionary asset management services without restrictions on types of assets being managed (INR or foreign) and without restrictions on nationality of customer.

2. Flexibility in equity, debt and hedge funds.
3. Creating subsidiaries/affliates offering asset management services.
4. Smooth handling of SEBI/RBI regulations and supervision for fund management by commercial banks.
5. Absence of government regulation of fees and service fees.
6. Offering non-discretionary asset management, hold or actively manage assets for individuals, firms and trusts, regardless of nationality of customer.
7. Investing across all asset classes, to ensure global diversification.
8. Clarity on the role of RBI/SEBI in regulation.
9. Lending against non-dicretionary portfolio value.

Besides being able to offer all the services provided by commercial banks, private banks need to be permitted to operate freely in the asset management space to do the following:

1. Discretionary asset management of high networth individuals' personal wealth portfolios.
2. Invest across global assets using equities, debt, securities, private placements, mutual funds, derivatives, hedge funds, commodities, gold, art, wine, *etc.*
3. Contract with foreign private banks to have HNWI client portfolios managed abroad.
4. Invest in real estate or real estate funds, and then offer a full set of real-estate related services such as property management.
5. Do non-discretionary portfolio management across global customers and global assets.
6. Receive identical treatment for local or foreign customers.
7. Have their fiduciary obligations protected when they obey client instructions which result in losses.
8. Have the freedom to decide fees and service charges.

Investment banks need to be permitted to do all of the activities listed above for commercial and private banks, both for discretionary as well as non-discretionary asset management, but in the context of investment banking. The same would hold good for brokerage and securities firms.

2.2. Asset management and fund managers

We look at the legal/regulatory environment as it exists for mutual funds, insurance companies, pension funds and hedge funds in India and list the requirements that must be in place to enable these entities to compete in a global market.

As far as mutual funds are concerned, most of the regulatory requirements for enabling discretionary asset management are in place. We already have the following:

1. Rules on qualification and capitalisation of fund manager which permit a steady pace of entry.
2. Sound regulation of fees, entry and exit by customers, trading of fund assets, valuation rules, periodicity and communication of NAV and portfolio composition.
3. Almost a full range of asset classes permissible, except forex.
4. Almost a full range of products that can be offered, excluding forex based products.

What we do not have in place in terms of mutual fund asset management is neutrality between Indian and foreign mutual funds and Indian and foreign assets. There are restrictions on Indian mutual funds investing abroad and foreign mutual funds investing in India.

In terms of discretionary asset management by insurance companies, we do have a fair amount of regulations in place. Insurance companies can:

1. Choose between insourcing and outsourcing of their fund management.
2. Sell policies which bundle insurance with fund management.
3. Sell annuities.
4. Freely decide investment of annuity purchase proceeds.

What is yet not in place in terms of regulations concerning insurance asset management is the following:

1. Neutrality between local and offshore assets. Insurance companies have restrictions in terms of investing abroad.
2. While permitted to bundle insurance with fund management, there is no tax neutrality with other fund managers. A lot of insurance schemes qualify for tax concessions.
3. Ability to sell 'with profit' endowment funds.
4. Ability to sell mortgage insurance policies.

In terms of non-discretionary asset management, the following is not permitted:

1. Sale of tailored life insurance policies
2. Sale of tailored annuities
3. Sale of tailored 'with profit' endowment funds
4. Sale of tailored disability policies
5. Sale of tailored risk policies for individuals

With respect to the pension fund asset management process, there is a long way to go as far as the regulatory framework is concerned. The following needs to be enabled from the point of view of discretionary pension asset management:

1. Full range of assets in pension portfolios from government bonds to real estate and hedge funds. The current regulations are highly restrictive in terms of where pension fund money can be invested.
2. Reduced protectionism in terms of foreign pension fund managers operating in India.
3. A regulated pension fund management industry which can obtain economies of scale off the local market and then seek foreign customers.
4. Local strength in fund trusteeship and administration.
5. Neutrality between local and offshore assets.
6. Regulatory framework based on prudent management principles giving the fund manager flexibility on asset allocation.
7. Treatment of defined benifit pensions, in addition to defined contribution pensions, in regulatory framework.

As far as non-discretionary pension asset management is concerned, the restrictions on personalised tailored pension funds and guaranteed annuities need to be taken away.

On the hedge fund asset management scenario, a beginning has yet to be made. We need regulations which will permit the following:

1. Establishment of hedge funds
2. Ability to engage in a full range of activities
3. Ability to invest in assets across national boundaries
4. Ability to have customers across national boundaries
5. Removal of limitations on trading, churning or leverage (including borrowing from banks and other sources of debt)
6. Settlement of issues concerning disclosure and risk limits

3. Personal wealth management

Personal wealth managers or private bankers as they are sometimes called, customize investment programs to meet the specific needs of clients and provide a range of asset classes across which the investments can be made on behalf of the client. Mostly offered by banks, the high degree of customization makes personal wealth management a very labor intensive activity.

In terms of commercial banks offering PWM services, the same regulatory issues as concerns non-discretionary asset management apply. Besides these, the following needs to be enabled:

1. Ability to offer and manage a full range of personal assets such as gold, commodities, art, wine, real estate *etc.*
2. Ability to provide the customer with comprehensive services as a one-stop solution. This would include property management services, credit card services, travel, entertainment *etc.*

In terms of private banks in India offering PWM services, the following needs to be done:

1. Removal of contraints against banks or specialist 'private bankers' offering private banking services.
2. Enable commercial banks to setup a private banking division, subsidiary or affiliate.
3. List out regulatory issues concerning client solicitation, invitation for PWM services, global assets, global customers including local and NRI customers.

Investment banks need to be permitted to do all the activities of personal wealth management listed above, but in the context of investment banking. The same would hold good for brokerage and securities firms.

4. Global tax management

Global tax management provides a business opportunity for financial intermediaries, typically banks, to build strategies that optimize a corporation's global tax liabilities. Regulatory structures need to be put in place to enable the following:

1. Serve local customers with global assets and global customers with global assets.
2. Deal with NRIs, firms or trusts owned by NRIs.
3. Do full service global tax management for Indian multinationals, which requires substituting the services provided by foreign banks, foreign accountants and foreign lawyers.

5. Risk management

Risk management is an important activity at an IFC. Risk management consultants work with clients to identify sources of risk and design integrated solutions. We look at the regulatory framework that would need to be set in place in order to enable banks, asset managers and funds and brokers/security firms to avail risk management services in India.

5.1. Risk management and banks

To enable commercial banks to offer/avail risk management services, the following would need to be enabled:

1. Operations in derivatives markets for hedging risks of the core commercial banking book and for clients on an agency basis (possibly in the context of a personal wealth management structure).

2. Identical structure for currency, interest rate and credit derivatives markets, regardless of whether INR or forex.
3. Ability to combat political risk through derivatives and insurance.
4. Ability to cover market risk and operational risk.

Investment banks would require a similar enabling framework with respect to investment banking activities. So would private banks for risk management of private portfolios in currencies, equities, bonds and commodities and risk management of discretionary funds.

5.2. Risk management and the asset managers

The regulatory framework for risk management activities by mutual funds is partially in place to the following extent:

1. Mutual funds are permitted to trade in equity and equity index derivatives.
2. There has been full integration of derivatives positions into rules about valuation and disclosure.

However a lot of risk management activities essencial for fund management are not permitted in India. So are risk management products. To enable risk management on an IFC scale, regulations would have to be put in place to enable the following:

1. Use of derivatives for full range of arbitrage, hedging and speculation
2. Currency derivatives
3. Interest rate derivatives
4. Political risk insurance or derivatives
5. Other underlyings such as weather or catastrophe risk
6. Risk management through insurance
7. Neutrality between local and offshore derivatives markets

From the point of view of insurance companies, regulations will have to enable the offering of financial risk reduction insurance products ranging across currencies, interest rates, credit risk, political risk, catastrophes, weather, and any risk that can be analysed in actuarial terms.

From pension funds' point of view, regulations would have to enable the following:

1. Do maturity transformation of pension fund cashflows.
2. Use of derivatives for producing pension guarantees.
3. Trade in equity, debt, derivatives, commodity and property markets.

And finally regulations that would permit hedge funds to use derivatives, insurance, proactive trading, short selling and leverage.

5.3. Risk management and securities firms

To enable brokerage/security firms to avail/provide risk management, the following would need to be enabled:

1. Risk management of private portfolios and discretionary funds, across all manner of derivatives markets (currencies, credit risk, political risk, equities, bonds, commodities)
2. Proprietary derivatives trading
3. Neutrality between local and offshore markets, and OTC or exchange markets

6. Financial markets

Most world class IFCs provide financial institutions which provide trading in various asset classes such as currency, equity, bonds, commodities and derivatives. We look at the legal/regulatory system from the point of view of banks, asset managers and funds, and securities markets in terms of their access to various asset classes in India.

6.1. Financial markets and banks

At present, Indian banks have limited access to currency markets. Commercial and private banks need to be enabled to do the following:

1. Full fledged participation in speculation, market-making, hedging and arbitrage for all currency pairs out of INR, USD, CNY, EUR and JPY futures, options, swaps and exotics.
2. Participation out of Mumbai in Chicago, New York and London markets.

Private banks also need to be enabled to give HNI clients global currency management and currency trading services along with multi-currency checking, savings and deposit accounts.

Investment banks should be able to offer clients multi-currency facilities with conversion rights across currencies through swaps and swaptions. They should also be in a position to do OTC and tailored multi-currency facilities.

In terms of equity trading, commercial banks need to be enabled to do the following:

1. Invest in equities for proprietary in-house trading, with full access to leverage and/or short-selling.
2. Offer equity trading and portfolio management facilities to individuals, trusts and HNIs.
3. Finance equity trades through collateralised leverage.
4. Market making on equity spot and derivatives markets.
5. Equity derivatives arbitrage.
6. Accept listed equities as collateral subject to risk-based limits.
7. Engage in all the above without concern for the location of the exchange.

Private banks should be permitted to do the following:

1. Have in-house proprietary trading account.
2. Create in-house funds for private clients.
3. Operate in domestic and foreign equity markets, including access to borrowed shares, short selling, and derivatives.

Investment banks should be enabled access to equity trading and be able to do all the above from an investment banking perspective.

Commercial and private banks need to be allowed access to the entire spectrum of bond market products enabling them to do the following:

1. Take long/short/leveraged/repo positions on government bonds, sub-sovereign, GOI-guaranteed, municipal, corporate ‘bonds’ and other fixed-coupon instruments, junk bonds, workout bonds, ARC bonds.
2. Do market making for exchange-traded bonds.
3. Originate and trade stripped/securitised assets based on a full range of underlying cashflows.
4. Have neutrality between Indian and offshore assets in all the above.
5. Not be under financial repression that forces purchases of Indian government paper or requires high credit ratings on corporate bonds.

Investment banks should have access to the bond market and be able to do all the above from an investment banking perspective.

Commercial banks should have access to derivatives markets which would enable them to avail/offer a range of products and services as follows:

1. Build arbitrage businesses in all kinds of derivatives trading as a robust fixed-income business.
2. Do market making on derivatives exchanges.
3. Hedge in-house proprietary trading accounts.
4. Risk-manage corporate or individual client portfolios.
5. Risk-manage internal bond portfolio based on risk considerations, without limitations on long or short positions, or a bias against options.
6. Risk-manage commodity exposure.
7. Offer full-service contracts to securities firms and hedge funds, involing financing, recordkeeping, information feeds, order routing, sales support *etc.*
8. Have neutrality between Indian and offshore exchanges.

Private banks must be enabled to risk-manage client or proprietary portfolios, provide liquidity and have open speculative positions and trade in equity, currency, interest-rate and credit risk.

In terms commodities trading, commercial banks should be enabled the following:

1. Market making and arbitrage on commodity futures markets.
2. Take open or hedged positions.
3. Finance commodity traders on a collateralised basis.
4. Hedge exposure owing to collateral.
5. Have neutrality between Indian and offshore exchanges.

Private banks must be enabled to do the following:

1. Diversify and enhance private client portfolios.
2. Participate in a full range of commodities, well beyond bullion.
3. Provide liquidity to clients against commodity portfolios as collateral.

Besides being able to do all the above in an investment banking context, investment banks must be able to develop innovative new commodity contracts and be able to trade on established CBOT/LME/NCDEX contracts.

6.2. Financial markets and asset managers

We look at the regulatory/legal framework as it applies to mutual funds, insurance firms, pension funds and hedge funds in an Indian context.

Mutual funds in India are not allowed access to the currency markets. In an IFS setting, mutual funds as well as hedge funds would be allowed to do the following:

1. Currency conversions associated with a global portfolio.
2. Trading in currencies as assets.
3. Hedging currency exposure of a global portfolio.

In terms of equity trading by mutual funds, we have some regulations in place. For instance the transperancy and disclosure requirements, NAV and customer redemption rules and rules about fund liquidation and distribution of proceeds are fairly clearly laid out. However mutual funds are not permitted the following:

1. Access to the market for global mutual funds
2. Investments all over the world
3. Full range of fund types (sector, risk, geography)
4. Access to borrowed shares, borrowed money, derivatives trading and short selling

On the bond trading aspect, mutual funds can do a lot more. We have rules in place on NAV and mark to market, holding to maturity, trading the yield curve and so on. Regulations provide the following:

1. Ability to create debt funds (government securities, corporate bonds, *etc.*)
2. Access to trading the corporate bond market

However mutual funds still face financial repression where rules require purchases of Indian government bonds or require corporate bonds to have high credit ratings. Funds do not have access to trading the government bond market or debt securities all over the world.

As far as derivatives trading by mutual funds is concerned, some activity is permitted. Mutual funds are allowed to hold open positions on derivatives on index or single stocks. They are allowed to do arbitrage using derivatives and these arbitrage positions are treated as being a fixed income position.

However the following is still not permitted:

1. Risk-managing the portfolio including specific derivatives positions associated with specific risks (*e.g.*, A yen futures position when there is an investment in a firm which imports raw materials from Japan)
2. Holding positions on markets across the world, which flow from the core portfolio which is internationally diversified.
3. Participation in credit derivatives.

On the commodities trading front, there isn't much that mutual funds are permitted to do at the moment. They cannot establish commodity funds, undertake commodity trading in general or take speculative positions on commodities in India or across the world.

Much of the issues discussed above that apply to mutual funds are also applicable to hedge funds.

Insurance companies have no access to currency trading. To be able to compete in a global market, these companies should be in a position to offer a range of forex denominated insurance products and engage in activities such as:

1. Produce products with premia or payouts in foreign exchange.
2. Take asset positions in foreign securities and currency markets.
3. Manage currency exposure on assets or liabilities.
4. Provide insurance to companies on their foreign assets or liabilities.

While insurance funds are allowed to invest and trade in local equities, investments into offshore equities are not permitted. Also, sound rules need to be formed about extent of asset allocation into equities, matching equity holding to long-term liabilities and reserve requirements on equity assets.

In terms of bond trading, insurance companies face financial repression, where rules require purchases of Indian government bonds or require corporate bonds to have high credit ratings. Investment and trading in government bonds and corporate bonds across all rating categories is not permitted. Neither are insurance companies allowed to invest in bonds in all countries. There is a need to have sound rules about matching of bond cashflows and liabilities as well as reserve requirements on bond holdings.

In terms of derivatives trading, insurance companies face issues similar to those faced by mutual funds. So also in terms of trading on the commodity markets. Investments in commodities such as gold or oil either through direct holdings or indirect paths such as ETFs is not permitted. Neither is trading and taking proprietary positions on commodity markets. Even hedging of commodity positions on derivatives markets is not permitted.

Pension funds should be able to take exposures in currency markets and design pension products which cope with foreign contributions or benefits, sell pensions to individuals or firms outside the country, globally diversify their assets and be able to manage currency exposure on foreign assets or liabilities. At the moment none of this is permitted.

While pension funds are allowed to invest in equity to a limited extent, they cannot hold equity indexes and individual stocks across countries. There are no clear rules about NAV computation of equity portfolios nor is there clarity about transperency and disclosure requirement.

As far as trading in bond funds, derivatives and commodities markets is concerned, the same issues that apply for insurance companies also apply to pension funds.

7. Securities markets

We look at the regulatory framework for financial exchanges that do currency trading, trading of equity and debt, derivatives trading and commodity trading. The only market in currency trading that exists in India at the moment is the interbank currency forward market. There is a need for an exchange that would offer spot or derivatives trading facilities on any currency pair. Similarly partnerships with global exchanges on transfer of currency derivatives positions need to be put in place. To enable entities to arbitrage and exploit price differentials across markets, there is need enable direct market access.

As far as equity trading is concerned, we have a fair degree of success in terms of the following regulations already in place:

1. Listing of ETFs including ETFs on closed-end funds, investment trusts, *etc.*
2. Disclosure and transperancy rules governing all trades.
3. Required minimum publicly traded stock that has to be issued.
4. Rules about proportions that can be owned by certain kinds of institutional investors.
5. Support for diverse array of market participants.
6. Flexible framework permitting multiple listing by a given issuer.
7. Sound rules about circuit breakers.
8. On-line realtime surveillance by exchange that is world respected.

What we are lacking in terms of regulations on the equity markets is the following:

1. Listing rules that enable listing of a diverse array of international issuers.
2. Listing of ETFs on commodities.
3. Neutrality between local and offshore issuers.
4. Support for borrowed shares and margin trading.
5. Consistency with global FATF approved AML-CFT regulations for members, dealers and customers.
6. Direct Market Access.

As concerns the bond markets, we have rules in place for listing of fixed income funds and ETFs. There are no restrictions on multiple listing. However the following still needs to be enabled:

1. Listing and trading of government bonds, sub-sovereign bonds, corporate bonds, with issuers from across the world.
2. Sound procedures for disclosure, transparency and surveillance.

3. Support for borrowed bonds, margin trading and short selling.
4. Direct Market Access.

On the derivatives trading front, a lot needs to happen. We need regulations in place that will permit the following:

1. Ability to innovate and create derivatives contracts on all underlyings in equity, currency, fixed income and commodities.
2. Global exchanges to trade local underlyings.
3. Placement of terminals by global exchanges in India and placement of terminals by Indian exchanges abroad.
4. Margin requirements based on overall portfolio risk, where there is an attempt at incorporating maximal information into the definition of the position, including OTC positions, asset holdings, *etc.*
5. International-style position limits.
6. Direct Market Access.

As far as commodity exchanges are concerned, there is a need for listing of all manner of futures and options on all types of commodities and providing fungibility of local contracts against those prevalent globally. All issues of market design and operations as seen with securities exchanges need to be implemented on the commodity exchanges.

As far are brokerage/securities firms are concerned, all issues that apply to banks in terms of trading on the various markets discussed above also apply to these firms.

8. Mergers and aquisitions

As organisations expand and diversify, global corporate deal-making has become an important activity. India has been an important player in this market. Regulations that permit banks to engage in M&A activity are well in place. Investment banks as well as commercial banks can engage in the following:

1. Arrange M&A among clients on a solicited/requested basis.
2. Arrange M&A among clients unsolicited, at investment bankers initiative.
3. Arrange M&A solicited/unsolicited among non-clients.
4. Promote M&A services in the corporate world in general.
5. Weave M&A into asset reconstruction or workout.
6. Do cross-border M&A involving Indian and non-Indian firms.
7. Play a role in M&A research and due diligence for the global market.

9. Leasing and Structured finance

Large scale projects often require funding from global sources, often by way of leasing or complex structured finance products. Regulations would have to enable both commercial and investment banks to do the following by way of financing alternatives:

1. Undertake structured leasing activities, under and international-style tax regime, for a full range of client-specific assets including aircraft, ships, containers, locomotives, wagons, cars, buses, trucks, computer equipment, *etc.*
2. Deal with assets abroad and assets subject to cross-border movement.
3. Be subject to sound provisioning requirements for leased assets.

From the securities markets point of view, we need regulations in place that would enable exchanges to offer spot and derivatives trading on securitised paper. So also enable them to offer a full range of complex derivatives required for putting together complex financing structures.

10. Project financing

To enable commercial and investment banks to do project financing, regulations must enable banks to do the following:

1. Structure and finance long gestation projects without restrictions on term lending (maturity, coupon, currency, collateral) and project bonds.
2. Issue long maturity corporate bonds, and use interest rate derivatives, in order to do duration matching.
3. Provide equity financing, convertible and subordinated debt, guarantees for export credits and suppliers' credit, financing import credits, *etc.*
4. Risk management of exposure through the project life (currencies, coupon, maturity transformation, performance bonds, contractor guarantees, *etc.*)
5. Construction financing.
6. Finance projects secured by a sequestered receivables cashflow (*e.g.*, Tolls).

Financial exchanges should be allowed to offer a full range of complex derivatives required for complex financing structures.

11. PPP Financing

PPP is probably the most obvious vehicle for putting together a physical and social infrastructure for a country like India. Much of the PPP activity in the world is done by investment banks. To make this happen in India, investment and commercial banks should be enabled to do the following:

1. Finance public obligations under PPPs (service provision financing, poor consumer financing, take-or-pay arrangements, maintenance cost subsidy, *etc.*).
2. Finance private sector obligations through performance bond guarantees.
3. Structure PPPs (legal, financial, accounting arrangements).
4. Access internationally credible PPP dispute resolution mechanisms.

12. Insurance and reinsurance

Risk management using insurance and reinsurance has become an important activity at an IFC. To enable banks and insurance companies to be able to offer products and services in this area, regulations need to enable the following:

1. Permit banks, both commercial and investment banks, to own insurance and reinsurance subsidiaries.
2. Have reasonable firewalls between banking and insurance operations.
3. Provisioning and investment for insurance risk without spilling into banking risk.
4. Creation of joint ventures with domestic or foreign insurance companies.
5. Selling insurance products through bank branches.
6. Use of tailored insurance products in the bank risk management process.
7. Being able to engage in derivatives transactions (*e.g.*, credit risk or interest rate risk) against insurance companies, either OTC or on exchange.

8. Selling insurance services either in India or abroad, either to an Indian client or to a foreign client.

Private bank client need to be able to participate in local or global insurance/re-insurance syndicates, such as Lloyds.

As far as insurance companies are concerned, regulations need to permit them to do the following:

1. Sell insurance products across the world insuring against global risks.
2. Participate in trading on the global reinsurance market.
3. Hold global portfolios in the management of assets.
4. Be subject to sound pruential regulations which do not discriminate against equity.
5. Participate in local and offshort, exchange traded and OTC derivatives.

To promote competitiveness in a global context, it is essential that entities operating in the insurance and reinsurance business are free from financial repression and are not forced to purchase Indian government bonds or restricted by requirements for corporate bonds to have high ratings.

Abbreviations

Appendix F

ADB Asian Development Bank

ADR American Depository Receipt

AMC Asset Management Company

AT Algorithmic Trading

AUM Assets under Management

BAMC Benchmark Asset Management Company (a mutual fund)

BCD Bond-Currency-Derivatives Nexus

BHEL Bharat Heavy Electricals Ltd. (an SOE electrical equipment maker)

BOB Bank of Baroda (an SOE bank)

BPCL Bharat Petroleum Corporation Ltd. (an SOE petroleum company)

BPO Business Process Outsourcing

BSE Bombay Stock Exchange

BSNL Bharat Sanchar Nigam Ltd. (an SOE telecom company)

BoP Balance of Payments

CAC Capital Account Convertibility

CAGR Compound Average Growth Rate

CBDT Central Board of Direct Taxes (the agency which implements central direct taxes)

CBEC Central Board of Excise and Customs (the agency which implements central indirect taxes)

CCI Controller of Capital Issues

CCIL Clearing Corporation of India Ltd.

CDO Collateralised Debt Obligation

CFMA Commodity Futures Modernisation Act

CMIE Centre for Monitoring Indian Economy

CRR Cash Reserve Ratio

DEA Department of Economic Affairs

DMA Direct Market Access

DOT Department of Telecommunications

EET Exempt-Exempt-Tax

EPFO Employee Provident Fund Organisation

ETF Exchange Traded Fund

FEMA Foreign Exchange Management Act

FII Foreign Institutional Investor

FIPB Foreign Investment Promotion Board

FMC Forward Markets Commission

FRBM Fiscal Responsibility and Budgetary Management Act

FSI Floor Space Index

FSMA Financial Services Modernisation Act

GAIL Gas Authority of India Ltd. (an SOE in the natural gas business)

GFC Global Financial Centre

GST Goods and Services Tax

GoI Government of India

HDFC Housing Finance Development Corporation (a financial firm working in home loans)

HNI High Net Worth Individuals

HNW High Net Worth

HNWI High Net Worth Individuals

HPCL Hindustan Petroleum Corporation Ltd. (an SOE petroleum company)

HPEC High Powered Expert Committee

IAS Indian Administrative Service

IDRs Indian Depository Receipts

IFS International Financial Service

IFSAT International Financial Services Appellate Tribunal

IGIDR Indira Gandhi Institute for Development Research

IIT Indian Institute of Technology

KPO Knowledge Process Outsourcing

KYC Know Your Customer

LCFI Large Complex Financial Institution

LIC Life Insurance Corporation (an SOE insurance company)

LLP Limited Liability Partnership

MAS Monetary Authority of Singapore

MOF Ministry of Finance

NBER National Bureau of Economic Research

NBFC Non Banking Finance Company

NCDEX National Commodity Derivatives Exchange

NCMP National Common Minimum Program

NDF Non Deliverable Forward

NGO Non Government Organisation

NRI Non Resident Indian

NSCC National Securities Clearing Corporation

NSDL National Securities Depository Ltd.

NTPC National Thermal Power Company (an SOE in electricity generation)

NUS National University of Singapore

OTC Over The Counter

PBR Principles Based Regulation

PFRDA Pension Fund Regulation and Development Authority

PN Participatory Note

PSU Public Sector Unit (Indian term for SOE)

PTCs Pass Through Certificates

PWM Personal Wealth Management

QIB Qualified Institutional Buyer

RBI Reserve Bank of India

RBR Rules Based Regulation (the opposite of PBR)

RFC Regional Financial Centre

RIA Regulatory Impact Assessment

SAT Securities Appellate Tribunal

SBI State Bank of India (the largest bank of India, an SOE)

SEBI Securities and Exchanges Board of India

SEZ Special Economic Zone

SLR Statutory Liquidity Ratio

SOB State Owned Bank

SPV Special Purpose Vehicle

STT Securities Transaction Tax

TDS Tax Deducted at Source

VOIP Voice over IP