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DEVELOPMENT AND REGULATION OF FINANCIAL MARKETS

In the backdrop of the global financial turmoil, securing and maintaining domestic financial stability was accorded priority from a policy perspective, with readiness for swift responses to any risk to financial stability from adverse international developments. The institutional framework for financial markets was further strengthened in terms of new instruments, better market infrastructure and enhanced prudential norms. The key measures aimed at the money market were designed to enable the market function smoothly in an environment of global liquidity squeeze and to contain the excessive stress on some of the segments. The Reserve Bank also took initiatives relating to improving the efficiency of the auction process, operational readiness for introduction of STRIPS, clearing and settlement of OTC rupee interest rate derivatives and revision of repo accounting norms. Measures were also undertaken to simplify the procedures in the conduct of foreign exchange transactions with a view to facilitating prompt and efficient customer service and the process of liberalisation of the capital account continued by further relaxing the regulations governing the movements of cross-border capital flows.

V.1 Deep and efficient financial markets are essential for realising the growth potential of an economy; however, disorderly financial markets could be a source of risk to both financial institutions and the economy. The serious ramifications of disorderly, volatile and disruptive conditions in the global financial markets became clearly evident during 2008-09. The strong inter-linkages among markets, financial institutions and the real economy also highlighted the significance of focused attention given to the development and regulation of markets in India. The severe stress condition in the financial markets of the advanced countries revealed that failure of a few systemically important financial institutions could create concerns about the counterparties that could even freeze the collateralised segment of the money market. Scare for hoarding liquidity could further dry up liquidity in such conditions in the collateralised segment of the market, because of re-pricing of risk, higher risk premium and use of stiffer margin requirements. It was also recognised during the crisis that provision of adequate central bank liquidity may not necessarily address the problem of market liquidity, as banks may not transmit the liquidity received

from central banks among the needy non-banks, that lack acceptable sufficient collaterals to access funding liquidity.

V.2 The contagion from the global markets did affect the Indian markets, particularly in the post-Lehman period up to November 2008, but swift and commensurate policy response from the Reserve Bank (as outlined in chapter I.V), ensured that the markets functioned normally and also remained orderly and resilient. The Annual Policy Statement of April 2008 highlighted the market developmental and regulatory policies for the year 2008-09 with a focus on developing a sound, efficient and vibrant financial system that ensures the provision of efficient financial services to the widest sections of the real economy. The Mid-Term Review of the Annual Policy Statement for 2008-09 focused on carrying forward development of various segments of financial markets and strengthening the financial market infrastructure. The broad policy objectives in the money market continued to be ensuring stability and minimising risk, while trying to develop new instruments and products. The Reserve Bank initiated various steps to further broaden and deepen the government securities market in

consultation with market participants. The Reserve Bank took initiatives to rationalise and simplify the procedures in the conduct of foreign exchange transactions with a view to facilitating prompt and efficient customer service. A number of measures were taken towards further liberalisation of foreign exchange transactions. This chapter sets out various regulatory and development measures initiated by the Reserve Bank during 2008-09 towards further widening and deepening of various segments of the financial market under its jurisdiction, viz., the money market, the government securities market and the foreign exchange market.

MONEY MARKET

V.3 For effective transmission of monetary policy and integration among various segments of the financial market, a developed money market is an essential precondition. In the context of the significant changes in the policy rates and liquidity operations of the Reserve Bank, the behaviour of the money market during 2008-09 assumed critical significance. Even prior to the crisis, with a view to improving the functioning of various segments of the money market and enhancing the smooth flow of funds across instruments and participants, a host of measures were undertaken by the Reserve Bank. These measures contributed towards improving transparency, facilitating price discovery process and providing avenues for better liquidity and risk management. During 2008-09, the key measures aimed at the money market were designed to enable the market function smoothly in an environment of global liquidity squeeze and to contain the excessive stress on some of the market segments.

V.4 The Reserve Bank introduced a special 14-day term repo facility for banks in October 2008 through relaxation in the maintenance of SLR up to 1.5 per cent of their NDTL to enable them to meet the liquidity requirements of MFs, NBFCs and housing finance companies. A special refinance facility was introduced on November 1, 2008 to provide funding to schedule commercial

banks up to 1.0 per cent of their NDTL as on October 24, 2008 at the repo rate. With a view to providing flexibility in the liquidity management of banks, the limit of the standing liquidity facility to banks in terms of export credit refinance was raised from 15.0 per cent of the eligible outstanding rupee export credit as on the preceding fortnight to 50.0 per cent in November 2008. The liquidity stress faced by mutual funds, particularly the money market mutual funds (MMMFs) during September-October 2008, was caused primarily on account of mobilisation of significant resources from large corporates and banks with redemption facilities on par with current accounts of banks. In view of the systemic implications of the activities of such funds, it was proposed to identify and address the macro-prudential concerns arising from the current framework in consultation with SEBI.

V.5 The Technical Advisory Committee (TAC) for Money, Foreign Exchange and Government Securities Markets had released the Report of the Working Group on Interest Rate Futures (Chairman: V. K. Sharma) in August 2008. The Working Group had recommended, *inter alia*, the introduction of a physically settled futures contract based on a 10-year notional coupon bearing Government bond. The Reserve Bank has already permitted banks to take trading positions in interest rate futures (IRFs). The RBI-SEBI Standing Technical Committee has completed the preparatory work and an exchange traded IRFs contract on the 10-year notional coupon bearing government bond is expected to be launched shortly.

V.6 With a view to assessing the factors impeding the development of the term money market and exploring the possibility of rejuvenating the market, a Working Group on the Term Money Market was constituted by the Reserve Bank in July 2007. The draft Report of the Group, submitted in May 2009, was discussed in the meeting of the Technical Advisory Committee on Money, Government Securities and Foreign Exchange Markets.

GOVERNMENT SECURITIES MARKET

V.7 The government securities market acquired renewed attention not only in the context of the fiscal stimulus plan of the Government but also on account of the marked preference for safety under conditions of stress in the financial system. In terms of market development, the Reserve Bank initiated various steps to further broaden and deepen the government securities market in consultation with market participants, which included: (i) improving the efficiency of auction process, (ii) new issuance structure for floating rate bonds (FRBs), (iii) operational readiness for introduction of STRIPS, (iv) new settlement mechanism for non-current account holders, (v) clearing and settlement of OTC rupee interest rate derivatives and (vi) revision of repo accounting norms.

V.8 With a view to improving the efficiency of the auction process for government securities and bringing it on par with the international best standards, an Internal Working Group on Auction Process of Government of India Securities (Chairman: H.R.Khan) was constituted. The recommendations such as reduction of the time gap between bid submission and declaration of auction results, withdrawal of the facility of bidding in physical form and submission of competitive bids only through the NDS, and submission of a single consolidated bid on behalf of all its constituents by the bank/PD in respect of non-competitive bids, have already been implemented.

Floating Rate Bonds (FRBs)

V.9 The auction of FRBs would be conducted as a price-based one as against the earlier spread-based and the base yield for the FRBs would be linked to the primary market cut-off yield of the 182-day treasury bills. The new format would simplify the methodology for pricing of FRBs in the secondary market. The auction of FRBs would be through the new auction platform being managed by the CCIL, which has the capability to facilitate issuance of various types of instruments, including FRBs.

Separate Trading of Registered Interest and Principal of Securities (STRIPS)

V.10 As announced in the Annual Policy for 2008-09, operational readiness for the introduction of STRIPS has been achieved. The guidelines that will govern the stripping and reconstitution of the government securities are being finalised in consultation with the market associations and the draft guidelines were placed on the website of the Reserve Bank on May 14, 2009 seeking comments (Box V.1). STRIPS will be launched during 2009-10 once the guidelines are finalised.

Netted Settlement Mechanism for Non-current Account Holders

V.11 A new settlement mechanism in government securities through settlement banks was formulated in order to facilitate direct access to NDS and NDS-OM for participants who do not maintain current accounts but maintain SGL accounts with the Reserve Bank. This new system would facilitate phasing out of current accounts of non-banks and non-PD entities with the Reserve Bank. Under this mechanism, while settlement of the securities leg will continue to take place in the SGL account maintained with the Reserve Bank, the funds leg will settle through 'Designated Settlement Banks' (DSBs) appointed by the CCIL. From June 30, 2008 onwards, secondary market transactions in government securities undertaken by mutual funds are being settled only through the DSBs. Arrangements for settlement of primary auction bidding under the new mechanism are being worked out.

Clearing and Settlement of OTC Rupee Interest Rate Derivatives

V.12 In order to strengthen the over-the-counter (OTC) derivatives market and mitigate the risks involved, a clearing and settlement arrangement on a non-guaranteed basis has been put in place through the CCIL for the OTC interest rate derivatives trades since November 27, 2008. By March 2009, 13 members participated in the non-guaranteed settlement of OTC rupee interest-rate derivatives.

Box V.1**Separate Trading of Registered Interest and Principal of Securities (STRIPS) – Operational Guidelines**

Stripping is the process of separating a standard coupon-bearing bond into its constituent interest and principal components. These can then be separately held or traded zero coupon instruments. For example, stripping a ten-year security would yield 20 coupon securities (representing the coupons), maturing on the respective coupon dates and one principal security representing the principal amount, maturing on the redemption date of the 10-year security. All the 20 coupon securities and the principal security would thereafter become zero coupon bonds. Reconstitution is the reverse of stripping, where the coupon STRIPS and principal STRIPS are reassembled into the original government security. An important feature of STRIPS is that the coupon STRIPS of the same date from different stocks are fungible - they are just not identical but exchangeable, *i.e.*, such coupon STRIPS do not refer to the bonds from which they are derived, and are identified by their maturity dates.

STRIPS help in improving liquidity and widening the investor base of the government securities market. STRIPS in government securities ensure availability of sovereign zero coupon bonds, which lead to the development of a market determined zero coupon yield curve. STRIPS also provide institutional investors with an additional instrument for their asset-liability management. Further, as STRIPS have zero reinvestment risk (discounted instruments with no periodic interest payment thereby obviating the need for reinvestment of intermediate cash flows arising out of the investment); they can be attractive to retail/non-institutional investors.

The stripping of designated treasury securities was introduced in the US in 1985. All treasury notes and bonds are currently strippable in the US where there is a large and active market for principal STRIPS. The UK introduced stripping of conventional fixed coupon in 1997 and while anyone can trade or hold STRIPS, only a market maker, Debt Management Office or Bank of England can strip strippable gilt or reconstitute it. France introduced treasury strips in 1991 and has the largest and most active STRIPS market in Europe.

In the Indian context, the Government Securities Act, 2006 permits stripping and reconstitution of government securities. The operational guidelines are being finalised in consultation with the market participants, the salient features of which

are as under:

- (i) Any entity, including individuals, holding government securities that are eligible for stripping/reconstitution (as notified by RBI from time to time) can strip/reconstitute these securities. Stripping/reconstitution, however, is permitted only in the eligible government securities held in Subsidiary General Ledger (SGL)/ Constituent Subsidiary General Ledger (CSGL) accounts maintained at Public Debt Office, RBI, Mumbai. Hence, any participant desirous of stripping/reconstituting government securities must open and maintain a demat account (SGL account or a Gilt account with a constituent) and hold government securities in electronic form.
- (ii) The process of stripping/reconstitution of government securities shall be carried out at RBI, Public Debt Office, Mumbai in the PDO-NDS as a straight-through process without any manual intervention.
- (iii) Holders of government securities shall place their requests for stripping/reconstitution with an authorised entity. Initially, all PDs would be eligible to authorise stripping/reconstitution requests.
- (iv) Stripping/reconstitution may be done at the option of the holder at any time from the date of issuance of a government security till its maturity.
- (v) All dated government securities having coupon payment dates on January 2 and July 2, irrespective of the year of maturity shall be eligible for stripping/reconstitution.
- (vi) The minimum amount of securities that needs to be submitted for stripping/reconstitution will be Rs. 1 crore (face value) and multiples thereof.
- (vii) STRIPS will be reckoned as eligible government securities for SLR purposes and retain all the characteristics of government security. They will be eligible securities for market repo as well as repo under LAF of RBI but with appropriate haircut.
- (viii) STRIPS, being zero coupon securities, trade at a discount and are redeemed at face value. To begin with, STRIPS will be tradable only in the OTC market and such trades in STRIPS need to be reported on NDS for clearing and settlement through CCIL.

Revision of Repo Accounting Norms

V.13 The accounting norms on repo transactions, prescribed by the Reserve Bank in 2003, treated repo as a set of two independent outright transactions. Amendment to the Reserve

Bank of India Act in June 2006, necessitated a review of the extant accounting guidelines to reflect the economic essence of repo as a collateralised borrowing/lending instrument and not as an outright sale/purchase transaction. Accordingly, a draft of

the revised guidelines was placed on the Reserve Bank's website on November 14, 2008 seeking comments and the final guidelines would be issued for implementation from April 1, 2010.

Auction Module for Government Securities (NDS-Auction) at CCIL

V.14 Auctions of Government of India dated securities were earlier conducted on the PDO-NDS platform developed and maintained by the Reserve Bank. However, in order to free system resources for the PDO-NDS and to improve operational efficiency, a new auction platform, *i.e.*, NDS Auction has been developed and maintained by the CCIL on behalf of the Reserve Bank. The new platform has the capability to handle auction of various types of instruments of Centre and State Governments including inflation indexed bonds, floating rate bonds and zero coupon bonds. Further, the platform can also handle non-competitive bidding in the auction of State Development loans in addition to the Government of India securities. The dated securities module of the NDS Auction has been made operational since May 11, 2009.

Primary Dealers (PDs)

V.15 As on July 31, 2009, out of 18 PDs, 11 were banks undertaking PD operations departmentally and the remaining 7 were stand-alone PD entities. Following the filing of Chapter 11 bankruptcy petition by Lehman Brothers Holding Inc. in the US, Lehman Brothers Fixed Income Securities Pvt. Ltd., a primary dealer, was advised on September 16, 2008 not to undertake transactions in the primary market of government securities. During the year, the PD operations of ABN AMRO Securities India Private Limited, a standalone PD, were taken over by its parent bank, *viz.* ABN AMRO Bank and the bank has been undertaking PD business departmentally since December 16, 2008. Morgan Stanley India Primary Dealer Private Limited was authorised to undertake Primary Dealership business with effect from July 20, 2009.

Corporate Bond Market – Settlement of OTC Trades

V.16 For facilitating settlement of OTC corporate bond transactions in real time gross settlement (RTGS) system on a DvP-I basis (*i.e.*, on a trade-by-trade basis), it has been decided, in consultation with SEBI, to allow the clearing houses of the exchanges to have a transitory pooling account facility with the Reserve Bank. Under the proposed settlement mechanism, the buyer of securities will transfer the funds through his bank to this transitory account through RTGS. The clearing house will thereafter transfer the securities from the seller's account to the buyer's account and effect the release of funds from the transitory account to the seller's account.

FOREIGN EXCHANGE MARKET

V.17 The foreign exchange market in 2008-09 testified the relevance of Reserve Bank's policy approach to exchange rate, foreign exchange reserves and capital account in the face of adverse external shocks arising from the global economic crisis. In the midst of the shocks emanating from the global financial markets, not only the transactions in already liberalised areas continued without any concerns, the process of liberalisation in the pursuit of fuller capital account convertibility also continued by further relaxation of regulations governing the movement of cross-borders capital flows, especially in the areas of inward and outward foreign direct investments, while recognising the downside risks emanating from higher level of capital outflows from the country.

Liquidity Enhancing Initiatives

V.18 The key policy initiatives taken by the Reserve Bank in response to the developments after September 2008 were essentially to improve the availability of foreign exchange liquidity by way of Reserve Bank selling US dollar into the market, opening a new foreign exchange swap facility for the banks and raising interest rate ceilings on FCNR(B) and NR(E)RA deposits to attract larger inflows. Cumulative increase of 175 basis points in

the interest rate ceilings each on FCNR(B) and NR(E)RA term deposits were effected between mid-September and November 2008.

V.19 The cap for loans by Authorised Dealer Category-I and authorised banks against the security of funds held in NR(E)RA and FCNR(B) deposits was enhanced from Rs.20 lakh to Rs. 1 crore on April 29, 2009. Banks were permitted to borrow funds from their overseas branches and correspondent banks to the extent of 50 per cent of their unimpaired Tier-I capital or US\$ 10 million, whichever is higher. The systemically important non-deposit taking NBFCs (NBFC-ND-SI) and housing finance companies (HFCs) were permitted to raise short-term foreign currency borrowings. The ceiling rate on export credit in foreign currency was raised by 250 basis points to LIBOR+350 basis points on February 5, 2009. Correspondingly, the ceiling interest rate on the lines of credit from overseas banks was also increased by 75 basis points to 6-months LIBOR/EURO LIBOR/EURIBOR+150 basis points.

V.20 The policy on the premature buyback of FCCBs was liberalised in December 2008, recognising the benefits accruing to the Indian companies as well as to the economy on account of depressed global markets. Under this scheme, buyback of FCCBs by Indian companies was allowed both under the approval and the automatic routes, provided buyback was financed out of foreign currency resources held in India or abroad and/or out of fresh ECBs raised in conformity with the extant ECB norms and out of internal accruals. As per the liberalisation, the total amount of permissible buyback, out of internal accruals, was enhanced from US\$ 50 million of the redemption value per company to US\$ 100 million, by linking the higher amount of buyback to larger discounts at which FCCBs could be bought back. Accordingly, under the approval route, companies were permitted to buyback FCCBs out of internal accruals with a minimum discount of 25 per cent of book value for redemption amount of up to US\$ 50 million; 35 per cent of book value for redemption amount more than US\$ 50 million and up to US\$

75 million; and 50 per cent of book value for redemption amount more than US \$ 75 million and up to US \$ 100 million.

V.21 Considering the continuing tightness of credit spreads in the international markets, the all-in-cost ceilings for different maturities were increased in respect of ECBs (150 to 250 basis points) as well as trade credit (75 to 150 basis points). Furthermore, the all-in-cost ceiling for ECBs under the approval route was dispensed with initially up to June 30, 2009, and later extended until December 31, 2009.

V.22 Measures were also initiated to safeguard the interest of India's export sector which was affected by recession in the global economy. The period of realisation and repatriation to India of the amount representing the full export value of goods or software exported, was enhanced from six months to twelve months from the date of export, subject to review after one year. Similarly, as a measure of relief to importers, the limit for direct receipt of import bills/documents from overseas suppliers was enhanced from US\$ 100,000 to US\$ 300,000 in the case of import of rough diamonds, rough precious and semi-precious stones by non-status holder exporters, enabling them to reduce transaction costs.

Continuity in Capital Account Liberalisation

V.23 Despite unfavourable international investment climate, the process of capital account liberalisation in India maintained its logical momentum, consistent with the overall approach to the capital account management. The regulations governing capital flows have been liberalised substantially in the past three years taking into account the macroeconomic conditions, state of financial sector development, risk management capabilities of financial institutions and depth of financial markets. At the same time, the Government has followed a hierarchy in the liberalisation of inflows by way of preference to equity inflows rather than debt from the point of view of the potential vulnerability of reversal of

capital flows, while having a diversified capital account to minimise the impact of a major shock arising from any single source.

Foreign Direct Investment (FDI)

V.24 During 2008-09, further measures were taken to support and strengthen the equity route by widening access of foreign firms to local equity markets, which had some sobering effect in reducing the market volatility experienced under the impact of the global financial crisis. Credit information companies complying with the Credit Information Companies (Regulations) Act, 2005 are allowed to invest as FDI up to a composite limit of 49 per cent, with the prior approval of FIPB and regulatory clearance from the Reserve Bank. FDI in commodity exchanges has been permitted within a composite ceiling of 49 per cent, with FDI limit of 26 per cent and FII limit of 23 per cent, subject to certain terms and conditions. In order to accord flexibility to FIIs to allocate their investments across equity and debt instruments, the restriction of 70:30 ratio of investment in equity and debt, respectively, has been dispensed with. The Government *vide* its Press Notes 2, 3 and 4 released in 2009 has further liberalised the FDI policy.

Overseas Direct Investment

V.25 Specific measures during 2008-09 intended to liberalise outbound investment included raising the investment limits for Indian corporate and mutual funds registered with SEBI, higher ceiling for mutual funds, permitted registered trusts and societies engaged in manufacturing/educational/hospital sector to make investment in the same sector(s) in a joint venture or wholly owned subsidiary outside India. The aggregate ceiling on overseas investments by mutual funds was enhanced from US\$ 4 billion to US\$ 5 billion in September 2007 and further to US\$ 7 billion in April 2008. In addition, limited numbers of qualified Indian mutual funds were allowed to invest cumulatively up to US\$ 1 billion in overseas exchange-traded funds as permitted by SEBI. Indian companies have

been allowed to invest in excess of 400 per cent of their net worth, as on the date of the last audited balance sheet, in the energy and natural resources sectors, such as oil, gas, coal and mineral ores with the prior approval of the Reserve Bank.

V.26 In order to facilitate eligible companies resident outside India to mobilise funds from the Indian Capital Market, the issue of Indian Depository Receipt (IDR) through a Domestic Depository has been operationalised with effect from July 22, 2009.

External Commercial Borrowings

V.27 The ECB policy is reviewed periodically considering the evolving macroeconomic conditions, inflation expectations, liquidity, build up of external liabilities and currency risk and the fiscal deficit. During 2008-09, the ECB route has been expanded for the services sector, *viz.*, hotels, hospitals and software, as companies engaged in these sectors have now been allowed to avail ECB up to US\$ 100 million per financial year under the automatic route for foreign currency and/or rupee capital expenditure for permissible end-uses. ECBs up to US\$ 500 million per borrower per financial year is permitted for rupee expenditure and/or foreign currency expenditure for permissible end uses under the automatic route. Definition of infrastructure sectors has been modified by including mining, exploration and refining. NBFCs, which are exclusively involved in financing infrastructure sector, are now allowed to avail of ECB from multilateral/regional financial institutions and government owned development financial institutions for on-lending to borrowers in the infrastructure sector under the approval route. Corporate engaged in the development of integrated township have been permitted to avail ECB under the Approval Route. SEZ developers have been permitted to avail ECB under the approval route for providing infrastructural facilities as defined in the ECB policy within the SEZ. The cumulative limits for investments by FIIs in government securities and corporate debts have

been increased to US\$ 5 billion and US\$ 15 billion, respectively.

Currency Futures

V.28 Since the launch of the first currency futures exchange in September 2008, currency futures contracts are being traded in three recognised exchanges. The functioning of the exchanges continues to be reviewed by the RBI-SEBI Standing Technical Committee. On the recommendation of the Committee, the position limits on the clients and trading members have been doubled from US\$ 5 million and US\$ 25 million, respectively, to US\$ 10 million and US\$ 50 million. The upper limits of 6 per cent and 15 per cent of the total open interest on clients and trading members, however, remain unchanged. The position limit for banks continues at 15 per cent of total open interest or US \$ 100 million, whichever is higher.

Asian Clearing Union (ACU)

V.29 Participants in the Asian Clearing Union (ACU) have the option to settle their transactions either in ACU Dollar or in ACU Euro. Accordingly, the Asian Monetary Unit (AMU) has to be denominated as ACU Dollar and ACU Euro. Banks operating in India have been permitted to pay interest, at their discretion, on ACU Euro Vostro accounts in addition to ACU Dollar Vostro accounts maintained by them. The decision to pay interest, interest rate and all other conditions would be at the discretion of the bank.

Inter-Regulatory Coordination

V.30 Following financial liberalisation, the boundaries between the specialised entities are getting blurred and entities are involved in activities that span across the domains of multiple regulators. Efficient inter-regulatory coordination removes the regulatory gaps, enhances the information flows between regulators and ensures that no systemically important entity escapes regulation. The G-20 Working Group on Enhancing Sound Regulation and Strengthening Transparency recommended that

there should be an effective mechanism for appropriate domestic financial sector authorities within each country to jointly assess the systemic risks across the financial system and to co-ordinate the domestic policy response to limit the build-up of systemic risk. The structure of this coordinating mechanism should be transparent, with clear assignments of roles, responsibilities and accountability for each authority. In this regard, in India, the inter-regulatory coordination is ensured under the aegis of the High-Level Coordination Committee on Financial Markets (HLCCFM) with the Governor of the Reserve Bank as Chairman, and the chiefs of the SEBI, the IRDA and the Pension Fund Regulatory and Development Authority (PFRDA), and the Finance Secretary, Ministry of Finance, Government of India as members. It is supported by separate technical committees for the Reserve Bank regulated entities, SEBI regulated entities and IRDA regulated entities. These committees review financial market/institution-related developments and attempt to identify any unusual developments that may require co-ordinated action. Besides, there are other committees to achieve inter-regulatory co-operation in the area of exchange-traded currency futures and interest rate futures, financial conglomerate monitoring, crisis management and corporate bond and securitisation (Box V.2). During 2008-09, five meetings of the HLCCFM were held as compared with two meetings in 2007-08. In the meeting held on October 1, 2008, the HLCCFM discussed exclusively the implications of the global financial turmoil for the Indian financial markets, reviewed the soundness of the systemic framework, and the preparedness of all regulators to act in a coordinated and timely manner to deal with the emerging situation in order to ensure continued smooth functioning of the financial system. The Committee decided to meet on a frequent basis to discuss the way forward in dealing with the effects of the global financial crises and subsequently held three more meetings.

V.31 In the domestic financial markets, the key measures aimed at the money market were designed to enable the market to function smoothly

Box V.2 Inter-Regulatory Coordination

One of the key lessons from the global financial crisis is the need for an appropriate and more effective coordination among all regulators to ensure joint responsibility for systemic crises, notwithstanding the mandated jurisdiction of any single regulatory authority. In India, the framework for co-ordination is well entrenched, as under, with the HLCCFM as the apex body for co-ordination.

Technical Committee on RBI regulated entities: The Technical Committee on RBI regulated entities with members from SEBI, IRDA and RBI meets generally six times a year and at short notice if any unusual development is noted by any of the supervisory agencies. RBI is the convener of the Committee.

Technical Committee on SEBI regulated entities: The Technical Committee on SEBI regulated entities with members from SEBI, IRDA and RBI provides an inter-agency forum to review capital market related developments with a view to identifying any unusual developments, and to coordinate action with other regulators based on early warning system developed by the committee. SEBI is the convener of the Committee. The committee meets generally six times a year and at short notice if any unusual development is noted by any of the supervisory agencies.

Technical Committee on IRDA regulated entities: The Technical Committee on IRDA regulated entities with members from SEBI, IRDA and RBI meets generally six times a year and at short notice if any unusual development is noted by any of the supervisory agencies. IRDA is the convener of the Committee.

There is a Standing Technical Committee comprising of members from RBI and SEBI that meets periodically as and when warranted, but at least once every six months to take stock of market developments and to sort out inter-regulatory issues.

Additionally, there are a few inter-regulatory committees (with RBI and SEBI members) that examine specific issues like introduction of currency futures and interest rate futures, and development of corporate bond markets (Corporate Bonds and Securitisation Advisory Committee-CoBoSAC).

Inter-regulatory cooperation is also ensured in the areas of supervision of Systemically Important Financial Intermediaries (SIFI) in the form of Financial Conglomerate (FC) monitoring framework established by the RBI, SEBI and IRDA.

To deal with unforeseen events, which could impact the functioning of the financial system, a Crisis Management Group is in place comprising senior officials from the Government of India, RBI, Government of Maharashtra, SEBI, IRDA, PFRDA, Bombay Stock Exchange, CCIL, Indian Banks' Association, Institute for Development and Research in Banking Technology, Multi Commodity Exchange of India Limited, National Securities Clearing Corporation Limited, National Commodity and Derivatives Exchange Limited, Fixed Income Money Market and Derivatives Association and Foreign Exchange Dealers' Association of India. The directory of the contingency contact list is periodically updated and circulated.

in an environment of global liquidity squeeze and to contain the excessive stress on some of the market segments, while at the same time trying to develop new instruments and products. The Reserve Bank took initiatives to improve the efficiency of the auction process, operational readiness for introduction of STRIPS, clearing and settlement of OTC rupee interest rate derivatives, new issuance structure for floating rate bonds and revision of repo accounting norms. Measures were also undertaken to simplify the procedures in the conduct of foreign exchange transactions with a view to facilitating prompt and efficient customer service. The process of liberalisation towards fuller capital account convertibility was continued by

further relaxing the regulations governing the movement of cross-border capital flows.

V.32 The resilience of the Indian financial sector in the face of the worst global financial crisis could be attributed to India's sound and well-calibrated approach to financial globalisation. With a view to mitigating liquidity risks, at the system as well as institution level, the Reserve Bank over the past few years has taken a number of initiatives, which include: (i) participation in the overnight unsecured money market has been restricted to banks and PDs and ceilings have been stipulated on their borrowing and lending operations in this market; (ii) prudential limits have been imposed on banks

on their inter-bank liabilities as a percentage to their net worth; (iii) asset-liability management guidelines have been framed that take cognizance of both on and off balance sheet items; and (iv) a detailed policy on the provision of liquidity support to Special Purpose Vehicles (SPVs) has been outlined in the guidelines on securitisation of standard assets. Apart from normal prudential requirements on banks, as part of dynamic provisioning and counter-cyclical capital requirement through revisions in risk-weights for specific assets, additional prudential measures in respect of exposures to specific sectors such as real estate, housing loans to individuals and consumer credit, have been

successively imposed. In the context of the global economic crisis, the scope for further strengthening of capital requirements, the credit conversion factors, risk weights and provisioning requirements for specific off-balance sheet items, including derivatives, is being reviewed. In India, complex structures like synthetic securitisation have not been permitted so far. However, going forward, introduction of such products, if and when considered appropriate, would be guided by risk management capabilities of the system, consistent with the policy goals of sound regulation, improving credit delivery, developing financial markets and promoting financial inclusion.