Using Banking Platform for Greater Role in Capital Markets

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Introduction

The development of capital markets in India started with the financial sector reforms in 1991. The Controller of Capital Issues was the primary agency that looked into issuance of securities by companies prior to the reforms. However, after the balance of payment crisis, it was decided to abolish Controller of Capital Issues and establish SEBI to give fillip to capital market development in India. Today SEBI is responsible for orderly development of capital markets in both equity and debt segments.

The reform period saw another development in capital markets which was the emergence of the mutual funds industry. Prior to the 1991 reforms, the UTI was the only major player in this segment. However, after UTI was bailed out by the government, it was decided that private participation will be permitted. Today mutual funds are a thriving sector of the financial markets offering variety of savings schemes such as equity, debt, balanced, exchange traded funds, commodity funds such as Gold ETF, monthly income scheme etc.

The role of the Banks in the settlement process was always there in the capital markets. But two events turned the course of events. First, a series of capital market scams in the 1990s prompted SEBI to once and for all abolish the physical certificate system and introduce the dematerialised system. This led to the creation of two depositories NSDL and CSDL.

Second development was the emergence of the National Stock Exchange, the first technology driven stock exchange in the country. Thus outcry system was also abolished and trading became online and anonymous.

The technology developments in the financial sector almost coincided with technology transformation in banking. The core banking solutions were introduced and by 2005 the settlements could be done through NEFT and RTGS. The digitization of banking broadened the product offering of banks. Most of the banks introduced online banking which allowed range of transactions to be performed without approaching the branch physically.

Digitization in capital markets also benefitted the banks and most banks became depository participants with NSDL or CSDL. Opening of demat accounts is today an important non-core activity of the banks.

Thus introduction of digital technology both in capital markets and banking paved way for accessing capital markets through banking platforms. Unlike the broking model, this model is based on the trust of banking entity and has become quite popular.

Today almost all banks offer bundled services i.e savings account, trading and demat account. All this can today be opened in one go. Further, account opening process has also been digitalised and can be executed online with the emergence of Aadhar and e-KYC.

Banking platforms and capital markets

The role of banking platform for greater participation in capital markets can be understood in two ways depending upon what kind of investor we are talking about.

If the investor in question is an active trader with fairly good knowledge of the online banking platforms, then online trading platform is one of the most popular methods to access the capital market. Equity buy/sell orders, both in cash and derivative segments, can be placed on NSE and BSE with live feed available. With SEBI making listing of corporate bonds mandatory on stock exchanges, similar buy/sell orders can in same ways be executed in debt segments. The trading platforms offer analytics based solution to monitor portfolio and profit and loss on daily MTM basis.

For passive investors such as those who do not want to take the daily volatility risk, mutual funds have become best option to indirectly approach the capital markets. Since mutual funds offer fee-based income to distributors, banks have been eager to act as distributors for various mutual funds. The online trading platforms invariably offer functionality to invest in mutual funds. Even without trading platforms, investment can be made using NEFT by opening an account directly with respective mutual funds.

Another passive mode of accessing capital markets is through the use of National Pension System. Unlike the EPFO, NPS offers options to have higher share of the savings to be invested in capital markets such as equity. Thus every bank offers a functionality to make contribution using online banking to their respective NPS accounts.

So far, the banking platforms have made the biggest impact in primary markets both in the equity as well as the debt segment. Investing in IPO has been revolutionised by the online banking facility offered across banking sector. The book running using the online method is less time consuming and has been able to attract large number of retail investors. The Applications Supported by Blocked Amount (ASBA) facility in a bank provides an investor the possibility to apply in any initial public offerings (IPOs), follow-on public offers (FPOs) and new fund offers (NFOs) of mutual funds.

More recently, many banks have graduated to include other facilities such as offering digital gold investments through online banking/trading accounts. This has created multiple emerging channels which facilitate retail participation in precious metals without taking delivery.

Further with the emergence of mobile banking, the functionality to approach capital markets using online banking is also made available through mobile banking.

Future and way forward

The role of banks as facilitator to access capital markets will continue to remain important because of the long-standing trust they enjoy in the financial system.

The size of the retail investor market has a very bright future because household savings constitute a major source of funds for this segment. The recent RBI data on flow of funds shows that household financial savings appear to have improved in 2019-20 mainly due to increase in bank deposits and sharper decline in loans and borrowings by households, whereas their investment in insurance and mutual funds remained at the same level as in the previous year. The use of equity – which had declined during 2017-18 owing to share buyback by corporate sector – bounced back during 2018-19. The share of mutual funds, which has been increasing over the years, declined during 2018-19, owing to volatility in the financial market.

Further, banks and other players cannot ignore the entry of fintechs in this sector. Fintech innovations are disrupting and re-imagining these functioning like never before. This is true across primary and secondary markets, including those for equity and bonds.

Fintech-driven innovation is influencing significant parts of capital markets' value chain, from sourcing capital to data and analytics services. These can be classified into four buckets. One is pre-trade, or access to capital. In India, crowdfunding platforms and bond issuances are in growth mode. Second, is trade execution. Fintech has led to cost efficiencies and enhanced trading security, thus helping end-customers.

The third is post-trade services. Investment in distributed ledger technologies (Blockchain) is increasing both in India and global markets. Changing regulatory and know-your-customer (KYC) services allow participants to access KYC information in real-time. Here too, more automation has meant improved security. Fourth is life cycle management, data and analytics, and value-added services. Investments in data and analytics are helping develop new techniques to mine and interpret data to its full potential.

Thus, access to capital is no longer limited to public platforms. Traditional forms have given way to new-age platforms such as crowdsourcing, private capital (exchanges), digital currency and social investments.

To conclude, the coming years will be very exciting for capital markets and banks, with their digital offerings, and they will play very important role in furthering seamless access to financial markets for retail customers.