30 years of capital market reforms

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Capital markets play a crucial role in the economic development of a country. They provide financial resources required for the long-term sustainable development of the economy.

Indian capital markets have a history of more than a century. The economic liberalization of the 1990s provided a lasting momentum and segments of India's capital markets are now comparable or more sophisticated than many of the advanced economies in terms of efficiency, price discovery, low impact cost and resilience, as evidenced by the impact of the Global Financial crisis on Indian capital markets. This underscores the importance of capital markets in building India's wealth. In the two years of the pandemic and after, 4.33 crores new investors have been registered with the National Stock Exchange of India Limited (NSE). Equally, at the end of June 30, 2022, NSDL had 2.8 crores demat accounts while CDSL had 6.85 crore accounts.

None of this could be achieved without reforms in the capital markets and over the past 30 years, starting from 1991, India has seen a slew of reforms that have strengthened and deepened the capital markets.

From a 5 percent cost per trade to zero brokerage, from a closed brokers club and old-world physical trading using the outcry method to electronic trading and settlement, the securities market in India now has state-of-the art technology, institutions, systems and processes. Starting with the setting up of the market regulator Securities and Exchange Board of India (SEBI) in 1992, the setting up of the National Stock Exchange (NSE), the setting up of the depositories and clearing corporations, the Indian stock markets are today state-of-the-art in terms of costs, efficiency and volume of business[1].

If we were to articulate the key reforms that set India on the path of becoming one of the top investment destinations and one of the most resilient globally, the first of the reforms was the establishment of the Securities and Exchange Board of India (SEBI) which got its legal status in 1992. SEBI is the capital markets regulator and its Preamble describes the basic functions of SEBI as "... to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto".

Establishing the National Stock Exchange (NSE) and NSE Clearing Corporation. NSE began operations in 1994 and was the first exchange in India to implement electronic or screen-based trading. NSE Clearing was the first clearing corporation to be established in India and first to introduce settlement guarantee. NSE and NCL oversee compliance by trading, clearing members and listed companies with the rules and regulations of SEBI and the exchange/ clearing corporation.

Establishing other key intermediaries viz. Creditors Rating Agencies, Merchant Bankers, Depositories, stock brokers, portfolio managers, registrars and transfer agents and others.

Risk management: SEBI and clearing corporations have introduced in India, risk containment measures that are superior to internationally accepted risk management practices. Risk containment measures include capital adequacy requirements of members, monitoring of member performance and track record, stringent margin requirements, position limits based on capital, online monitoring of member positions and automatic disablement from trading when limits are breached. Mandating interoperability amongst clearing corporations, allowing traders to consolidate trades across multiple exchanges and submit them for clearing and settlement to a clearing corporation of their choice, is also an important development.

Mutual Funds: The growth of mutual funds in India has helped the capital market to leapfrog to a different level. Assets Under Management (AUM) of Indian Mutual Fund Industry as on July 31, 2022 stood at INR 37,74,803 crore. The total number of accounts as on July 31, 2022 stood at 13.56 crore.[2]

Insurance Sector Reforms: Indian insurance sector has also witnessed significant reforms in last few years. The Insurance Regulatory and Development Authority (IRDA) was set up in 2000, which paved the entry of the private insurance firms in India. Both general insurance premiums and life insurance premiums have been showing significant growth, with life insurance premium in June 2022 reaching Rs. 31254.55 crores.

Introduction and development of ETFs: Globally and in India, exchange traded funds (ETFs) have emerged as a popular product and provide liquid exposure to investors in a cost effective way.

One important innovation permitted by SEBI is online KYC. The recent phenomenal growth of retail investor participation in the market would not have been possible without this non-physical mode of onboarding investors. As Dr. S. Jaishankar recently wrote, most developed countries are way behind India in terms of accepting technology as a way of life. The deep and wide penetration of telecom networks, bringing the world's cheapest technology to our country has significantly helped in drawing in new investors and mobile and internet trading.

Investor protection measures: As the SEBI Chairperson said in a statement on the occasion of the Global Money Week 2022, a consumer of financial markets always expects the markets to be transparent, fair and a safe place to transact in. Towards this end, SEBI has endeavored to ensure market integrity, provide investors with simplified investment processes and have a robust investor grievance redressal mechanism. Some of the measures include client asset protection through pledge/ repledge of securities, upfront margining, segregation of client collateral and monitoring and visibility of collateral at client level.

Gold exchange: The Union Budget for FY 2021-22 announced the setting up of gold spot exchange with SEBI as the regulator. This is expected to infuse transparency in spot gold transactions and over a period of time enable India to emerge as a global price setter for the commodity.

Lastly, performance of the Indian Economy: Gross Domestic Product of India has grown from USD 320 Billion in 1990 to USD 3.17 Trillion in 2021[3], raising income and wealth of investors. Investment patterns are slowly moving to investment in capital markets. Jeffries estimates that the share of capital market investments in total savings by Indians is now at 4.8%.

India's capital markets have come a long way in the past 30 years. According to a 2020 report of the Financial Stability Board, globally, the non-banking financial sector grew faster than the banking sector in the past decade. The report also states that financial assets of the non-banking financial sector amount to more than USD 200 trillion, accounting for nearly half of the global financial system. A large part of the non-banking financial intermediation is through capital markets. Going forward, capital markets will play an increasingly important role in funding economic growth and reforms and development of the capital markets require an ongoing focus and effort from the regulators, exchanges and intermediaries.

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[1] 30 Years of Reforms | What does the report card look like?
[2] AMFI
[3] World Bank