




PICKING UP *the* PACE

In January, Global Custodian visited Mumbai to bring together a range of sub-custodians, both local and multinational, to discuss developments in the Indian market from a post-trade perspective. The discussion, both lively and wide ranging, will be presented over the next two issues of the magazine.

Here we begin with an overview of how service providers themselves account for the change in perception of market efficiency over the past 25 years and how much room for growth in securities services remains.

(Not long after the roundtable took place, India's two largest stock exchanges—National Stock Exchange of India (NSE) and BSE—placed restrictions on the provision of data that allows their index derivatives to be traded abroad. We have outlined the position in a postscript, but will return to this live issue in the next edition.)

Richard Schwartz: The purpose of this roundtable is to bring to the attention of Global Custodian's readership what it is they need to know about the Indian market that's perhaps different from what they're used to. Perceptions of efficiency in the Indian market have really changed radically over the past decade. Is that because competition has led you there, collaboration has led you there, regulation has led you there, how did that happen?

Ravi Varanasi: In the 1990s, there was a significant change in regulation and a shift in the way the market works here. SEBI has in fact made a series of interventions in the last four or five years to change the entire scenario, while operational processes have been simplified over the same period. The compliance culture that has evolved in the last two decades has also helped to change perceptions.

Viraj Kulkarni: I think basically it goes back, way back. In 1992, for example, the economy was not in great shape and the market was very closed. The driver of the change was the need to get more inflows into the country. So the liberalisation process set the whole ball rolling. Since then changes introduced by the regulator, SEBI, government action and the advent of the National Stock Exchange bringing electronic trading, combined to accelerate change.

Vivek Harlalka: I still remember very vividly that NSE started in November 1994. The Bombay Stock Exchange (BSE) was the oldest stock exchange in Asia, but NSE came in 1994 with its electronic trading platform. The shift from an outcry system to an online platform led to much more transparency and healthy competition and BSE moved to its own electronic trading platform. The approval process for foreign investment has also been decentralised over time. More powers and responsibilities have been given to custodians which has helped encourage overseas investment flows into India.

R. Anand: As all of us in the room know, and as Viraj has alluded to, there were some problems in the capital market around 1991-92 which triggered the government to begin making the changes mentioned. I'd add dematerialisation and the introduction of a CSD as important factors as well. I see it as a combination of collaboration, completion and government-driven policies that have encouraged the introduction of global best practices into the country.

It's important to point out too that SEBI was only given statutory powers in 1992, although it was formed in 1988.

Hans Prakash: From 2014 onwards, there has also been a new era of reforms that have given a boost to capital markets. You know derivatives trading in India commenced in 2000. Today we are the largest market in terms of exchange traded derivatives with daily volume of around $150 billion. This kind of growth that we've seen across derivatives and even other asset classes has been quite unprecedented.

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>
> HANS PRAKASH, IL&FS SECURITIES

David Jaegly: I'd say the market infrastructure that has been built in the last 20 years has provided a solid foundation for that growth.

Atul Badkar: I think we all agree that in 1992 when SEBI came in,

that was a trigger point. It's almost like BC and AD. We managed to dematerialise very quickly in comparison to a lot of peers. Such progress was a result of the collaboration among the regulator, exchanges and market participants. In the 25 years from 1992 till 2017. there's been a huge shift and we have come a long way.

Vivek Harlalka: There are 1.66 billion demat accounts at NSDL and around 1.93 billion at CSDL [the two central depositories], so if you look at the pace of dematerialisation, it's significant. From a service provider point of view, the changes in technology and infrastructure, the move to rolling settlement and the speed with which information now passes among participants in post-trade processes means we have to keep on our toes. Blockchain is going to be another thing that will affect the markets.

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>
> R. ANAND, STOCK HOLDING CORPORATION

R. Anand: To add to what Vivek said, India moved to T + 2 in 2004, much before the European markets and the US. We had to learn how to handle that environment and it was a challenging time. All of us had to adapt to these changes. In fact we have been regularly collaborating with the regulators and with the other intermediaries so that the settlement cycle becomes even shorter

Sachin Samant: Service providers had not only to adapt but also

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to bring best practices from other markets, sharing them with the regulators to see what was appropriate locally. This collaborative effort helped to stimulate the growth of market, but it was still a restricted market dominated mostly by the foreign custodians.

The market truly opened in 2014 when the Indian custodians also started fighting for market share. Regulation now made them more competitive. Compared to 25 years ago, the market is basically unrecognisable.

But in the last three to four years, access for foreign investors to the Indian market has also revolutionised. There used to be three or four different routes for foreign investors to access

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> VIVEK HARLALKA, BNP PARIBAS

Indian capital markets, leading to some confusion. All that has been addressed. FII registration used to take a log time, now registration is given within 30 days, as mandated by SEBI. In that regard, the local custodian is actually to some extent an extended arm of SEBI in some sense.

Vivek Harlalka: When you speak to overseas investors, they are often surprised that NSE is listed among the top five exchanges globally in terms of futures and index options. Average daily turnover is around $110 billion. In the cash equities segment, it's around 1.6 billion.

Atul Badkar: We need to do a better job as a market of getting the message out there – not just the capital markets, but the financial system as a whole. A simple case in point: in 2000, total credit outstanding was around INR 4 trillion. It has now moved to INR 80 trillion in 2017. The deposits have moved from INT 9 trillion to INR 110 trillion in 15-17 years. GDP between 2000 and 2017 has moved from $ 500 billion to $2.2 trillion and we will move to $4 trillion by 2024. This broader growth story also needs to be told to investors.

Richard Schwartz: There are two things that come out of the discussion we've had so far. One is the question of best practices, I'm interested in how the market came to understand what the best practices are and implement them.

Hans Prakash: Again it's collaborative. As Viraj mentioned, we have a very strong regulator, fantastic exchanges and an ecosystem of custodians. There are also suggestions coming from the market participants. SEBI and the exchanges are also looking at various global practices and introducing them to India. This has had a particular impact on the derivatives market.

Atul Badkar: Some of this is also the result of introspection on the part of the custodians. We cannot implement all suggestions that have been put forward but we are adopting a sustainable approach. We haven't gone too fast. Could we move faster? The answer is yes, but collaboration, competition and introspection are taking us forward.

Hans Prakash: I actually think we've moved pretty fast as a market. Until 1992, we were slow and lagging behind, but what has been achieved in the last 25 years is very, very fast. For example the derivatives market has been growing leaps and bounds.

Richard Schwartz: In a lot of other markets that have removed manual processing from the market, you've seen consolidation amongst providers of securities services and here there seem to be a relatively large number of custodians, both international and domestic. Why is that automation not leading to some consolidation in service provision?

Viraj Kulkani: The regulators here were relatively conservative in their approach and that's why you've not seen any of the sorts of hiccups happening in the market, that perhaps have been seen elsewhere. The regulators are also keen to learn what's happening in the market. Last June, for example, SEBI came out with a consultation paper, sought information from custodians and others on how to ease market processes.

Given that the potential market is huge and that new products are coming in, the number of custodians has actually increased from 14 to 19. Consolidation will eventually happen, but I don't expect it for some time.

Sachin Samant: There are still a lot of local investors coming into the market. Only a tiny percentage of the Indian population invests in the markets. There's huge scope for evolution in domestic investment. The market is far from saturated.

Vivek Harlalka: When we talk about custody, there are local mutual funds as well. The local mutual fund industry is growing at a very rapid pace. If you look at the total assets under custody

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of the local mutual funds as of November 2017 as per SEBI data, it's USD $309 billion.

There have been local custodians who have focused much more on the local asset manager, where some of the multinational custodians have not made many inroads.

Richard Schwartz: Looking at the next three years, given the fast pace of change, what are you preparing for in your own business-

es that you think is going to happen, both in terms of foreign investment and domestic institutional investment.

Sachin Samant: India has had an excellent run of macro results for the last three years with low oil prices and therefore low current account, low fiscal deficit and low inflation. We offered a positive real rate of interest for a reasonably long period of time and foreign investors can come in without too much difficulty. Add to that a fast growing economy and abundant inflows of liquidity, the results are there to see.

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Demonetisation has also led to a formalisation of savings and a lot of money has flowed from land and gold into financial products. Local mutual funds have grown in the 30% range year-on-year. For such a large industry such growth year-on-year for two consecutive years is substantial. Although oil prices are a bit of a worry in the short term, we see promising figures in automobiles and cement among other segments. Indian corporate earnings will start looking up and therefore investment will still keep coming in. I think on the foreign investor side, the liquidity position will probably taper to some extent, but India will remain a relatively attractive investment destination.

So from the perspective of both FPIs and domestic money, we as custodians need to be prepared for ever larger volumes.

Hans Prakash: We have been able to adapt accordingly to ensure that we are able to cater to the various classes of customers. As local custodians we are well geared up as our foreign peers to cater to both domestic and foreign investors.

Atul Badkar: Just to add to that point, while spoken of consolidation within custodians, we at Edelweiss have been custodians for quite a while, but actually only began to focus on it in 2014. Three years later, we are prominent participants in the GC survey. It goes to show that there is place for new entrants in this market.

Richard Schwartz: Okay, so consolidation is not for today, but eventually, as Viraj says, it will come. From what you've heard so far and what you hear from international investors looking get into India, is there anything else that you are expecting or looking for SEBI and the regulators to do to facilitate FPI investment?

Viraj Kulkani: One set of custodians who have been wanting to come to the market and have not been able to make it because of the regulations are the global custodians who are not directly involved here with a physical presence.

Richard Schwartz: What are they waiting for?

Viraj Kulkani: What they are expecting is a regulation to be passed by the Central Bank which enables differentiated banks to come in. Otherwise you end up needing a banking license to offer all of the products other than what these specialist providers do. This is already under consideration.

The second thing that will really make a difference is interoperability between the clearing corporations. Once that comes it will make a visible difference. We need to create more visibility about the things which are happening out there.

The second part of this roundtable, to appear in the Summer edition, will cover, inter alia, stock lending, derivatives, electronic trading and foreign versus domestic institutional investors.

The RENEWAL PROCESS

Ashish Chauhan is the MD and CEO of BSE, paradoxically both the oldest exchange in Asia and the fastest exchange in the world with six micro seconds response time. Global Custodian asked him about his strategy.

Global Custodian: You've turned around what is a very old institution and, when that happens, some people are very enthusiastic about change and some people have to be encouraged to go along with it. So if you look at the participants in the old Bombay Stock Exchange did you have a lot of hard work to get people on board?

Ashish Chauhan: Well it's always hard work to change an old system, particularly one that was 135 years old when I joined. Some people had given up on the BSE. Since then, we have come back. First we had to clean ourselves up, focusing on four or five specific areas. One obvious one was technology, not only for trading, but collateral management, banking, broker management, listings... the entire network.

We also had to acquire newer members because ours was a physical location-based membership, you had to be in the building to be a member. We had to attract people from outside and in the state we were, that was tough. We had to attract new talent, but nobody saw a career here. Our only products were stocks, and so we had to go into all other products very, very quickly. We were also in need of regulatory reform.

Now thinking back over the past eight years, I think we have achieved reasonable progress in all those areas. Today technologically we are the fastest in the world, our trading, clearing everything has changed, network, hardware, software, whatever you can think of we have changed it.

GC: Did you do all that internally or did you buy in?

AC: We've built most of it internally, but not exclusively. For example, in the area of security we have internal people and external people. For trading, we bought software and modified it to our requirements, using both our own in-house expertise as well as TCS people. We have a very large technology team now which is a separate company because the skill sets required are different from the traditional stock market norm.

GC: So does the fact that you are the fastest in the world mean you've attracted a different set of participants, such as high frequency traders?

AC: Speed is one parameter which people consider for trading, but there are probably eight to 10 others. Bragging rights are very important, however. It also keeps you on your toes because your entire team knows that you are the fastest and you'll want to remain fastest. That keeps you on a different technological curve.

GC: Do you offer co-location?

AC: We do have co-location, It is extremely fast, very, very sophisticated but extremely low cost.

GC: In the face of competition, what would you say is now your USP?

AC: Ten years back or even five years back, if you had asked about BSE technology, people would have looked around bewildered. Today everyone in the market recognises the strength of BSE technology either by reputation or through experience. We've also gained people's trust by refusing to cut corners. Although we have lost some business as a result, we have gained more.

In terms of getting business we have two strategies; one is what you might call the

Ashish Chauhan is the MD and CEO of BSE (formerly Bombay Stock Exchange), the oldest exchange in Asia and the fastest exchange in the world with six micro seconds response time. BSE is also the largest exchange in the world with more than 5000 companies listed.

From 2000 to 2012, prior to joining BSE, Ashish Chauhan worked at Reliance Industries limited, India's largest business house as President and Group CIO, Head of Corporate communications and CEO of Cricket team Mumbai Indians in its formative years. From 1993 to 2000, he worked on setting up India's National Stock Exchange (NSE).

He is currently the chairman of South Asia Federation of Exchanges with 23 member organisations and is also a distinguished visiting faculty at Ryerson University, Toronto, Canada.

red ocean strategy, where there are already incumbents and you need to battle it out. The blue ocean strategy addresses new and nascent opportunities like SMEs, where we have a 75% share, or public auctions and buybacks.

Mutual funds are also an interesting area. India is one of the rare countries where most mutual funds are active rather than passive. Active funds are distributed through the exchange. We have around 80% market share on these funds, but also a 20% of all the mutual funds distributed in India of any kind, largely as a result of the innovation we've introduced around the former. We also have 50% of all the new mutual fund customers coming into the market.

GC: Down the road you're entering commodities.

AC: We are going to launch commodities in October. We have also become very large in currencies. Our SME business is also growing very nicely. We have around 220-odd companies listed, out of which 40 have moved on to the main board and we have a kind of a structured programme to encourage that.

We'll soon have 40-50 in the pipeline, preparing for IPOs, looking to raise from as little as US$100,000 dollars to US$100 million, and we have one layer below that, an incubator run by Ryerson University of Canada for the exchange. Through that, we have funded 146 companies, which were really small, but many of which have grown to become 200 people companies and moved out of the incubator.

GC: Is that incubator layer primarily FinTech companies?

AC: They are more Hi Tech companies, but not necessarily FinTech. It's very mixed.

GC: I gather you are quite involved in the SWIFT India project?

AC: We have been working to standardise the messaging infrastructure of the markets. For the first time anywhere, SWIFT created a subsidiary in India to help with that. We basically set up a new service bureau first to handle messaging for funds, but with eventual plans to move into broader securities.

GC: How do you deal with the inertia that obviously arises from someone having a system that works and not wanting to invest in a new one?

AC: It's a slow process, we have done it in mutual funds, we have done it in currencies, but you need patience, though from a technology perspective we can move very fast.

GC: And I suppose one advantage of SWIFT generally globally is the ability to reuse the same messaging infrastructure?

AC: Yes; there are many players who already do that, but have not been able to extend the benefits to India. Once this comes in, it puts them in a better position.

Foreign institutional investors who want to use providers that are not necessarily among the big five or six will also be able to take advantage of that capability.

The ROAD AHEAD

Vikram Limaye, CEO, NSE, sat down with Global Custodian in Mumbai to outline his vision of where the Indian securities markets need to focus in the sort to medium term.

Global Custodian: Obviously NSE has had a big hand in helping to shape the Indian capital markets ecosystem. Is there anything still missing in your view?

Vikram Limaye: There's a lot that can be done from a market development perspective. The list is actually quite long, if we want to broaden the investor base. While 5% of household savings are in equities today and the equity markets in India are relatively well developed, we need to increase both retail and institutional participation in equity markets. For other asset classes, markets are at very early stages, whether it is bonds, commodities, currencies, credit derivatives, interest rate swaps, etc.

Part of it has to do with regulation, part of it has to do with the ecosystem not being developed the way it needs to be developed for these markets to take off. In many of these areas, institutional participation is not where it needs to be. Institutional capital in India is controlled by four different regulators, amongst whom there needs to be alignment to develop a market. Various people have to come together and move in the right direction. Obviously the Exchange also plays an important role. I'm hopeful of market development because people at senior levels in government and the regulators are interested in moving in this direction.

I do feel that a lot can be done in terms of surveillance of the market to ensure fair market practices and that trust in markets is enhanced. For that, we have to use big data analytics and artificial intelligence to see how we can try and predict patterns of trading and behaviour.

From a systemic risk perspective, we need to keep on top of cyber security risks because that obviously is a huge threat. Unfortunately 99.9% uptime for an exchange is not good enough; it has to be 100%. And the cast of characters you're dealing with for cyber security threats is increasingly sophisticated. Many of them could also be state-funded, so you have to stay ahead of the curve. Investment in technology is critical to be at the cutting edge of prevention.

GC: Will the introduction of a common platform for equities and commodities later in the year make that easier or more difficult?

VL: It's certainly easier for members, because you're trading from one account and to that extent it's easier to move margins and collateral across different segments if you're on one exchange.

GC: What's the impact going to be on competition?

VL: The commodities market had a separate regulator called the FMC (Forward Markets Commission). This was merged with the securities regulator, SEBI. So now we have one regulator, which is why bringing commodities and equities together is also feasible. The first step was to permit the brokers to have a unified entity for commodities and equities. Competition will increase with exchanges being permitted in all asset classes.

GC: And that is still on target for October?

VL: That's right. NSE will be ready to offer commodities contracts from October 1.

Vikram Limaye is the managing director and CEO of the National Stock Exchange of India Limited (NSE), the world's second largest exchange in cash market trades and one of the top three exchanges in index and stock derivatives volumes. Prior to joining NSE, he was the managing director & CEO of IDFC Limited, a diversified financial services conglomerate.

He has contributed to various committees of government and industry associations on a range of topics, including infrastructure, economic policy, markets, trade and minority affairs.

GC: This may be a bit of a cheeky question, but if you were still at Credit Suisse First Boston, if Credit Suisse First Boston still existed, and a client came to you and asked for comment on the Indian equity market and its pros and cons, is there anything that stands out that you think foreign investors would need to know about the current structure of the market?

VL: In terms of overall growth prospects, the country is in a good position. We have good macroeconomic stability and good political stability. Those are important ingredients for foreign investment. Over the last 18 months; there have been structural reforms that the government has put in place that have led to some slowdown in near-term growth for the economy. Growth is expected to pick up in the next two to three quarters once these reforms stabilise.

From an investor's standpoint, I would say the markets are well regulated and risk management in the markets is very strong and amongst best in class compared to other markets. I think regulation has come a long way in order to facilitate foreign investment in India and fair market practices. More can be done in terms of new products, but that is a continuous process. We have a very robust futures and options market. In fact if you look at the volumes in options, NSE is number one in the world and in futures is number two behind CME. It's a very large, well-regulated, liquid market.

The other good thing that has happened in the last couple of years structurally, which is a positive for the Indian market, is that the dependence on foreign investors has gone down. Three years ago, if FIIs had pulled out US$500 million from the market, it would have moved the index and the currency materially. Now domestic buying power has gone up quite significantly, because flows into domestic mutual funds have been very large over the last two years and even more so in the last one year post-demonetisation, so that's a positive thing. It cushions volatility. Almost $1 billion a month in mutual fund flows is through systematic investment plans which is a steady form of investing small amounts periodically through cycles rather than trying to time the market. My hope is that it continues; we haven't seen a major correction in the market to test that.

We need to have more quality companies to invest in. Today there are about 1800 companies listed on the NSE. We need to get more quality companies to list, to broaden the availability of investment opportunities. The government could use stable markets to list some of its public sector undertakings and divest some stake.

The SME landscape is also a very attractive landscape. We have started a dedicated platform for SME listings called NSE Emerge. We've got about 120 companies that are now listed on that platform. The pipeline is very strong; I think probably another 40-50 are likely to list in the next six months. Providing access to capital to companies is an important part of our role as an exchange. For SME companies it's particularly important because access to capital is one of the problems that SMEs have.

GC: Is there much demand for remote participation; are you getting lots of foreign brokers wanting to trade directly on the local market?

VL: Demand for remote participation by foreign brokers wanting to trade directly on the local market, is sporadic and in form of inquiries.

Local regulations (SCRA, SEBI, Tax) require foreign brokers wanting to trade directly on the local market to have on ground presence (India presence). Hence remote participation is not permitted.

In the last decade, over 35 leading foreign brokers have established presence by setting up local legal entities. These entities are registered with SEBI as well as with Indian Tax authorities (PAN card, tax filings etc.); contracts issued by them are subject to local legal jurisdictions.

SEBI and NSE (for brokers who are its members)) have considerably improved the ease of doing business for entities set up in India, by permitting them to provide direct market access (DMA) facilities offshore.