Headline: Capital market challenges of a high growth economy	
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Capital market challenges of a high growth economy

Regulators and participants will have to deal with a host of them, from non-traditional players challenging the status quo to the growing role of technological innovation

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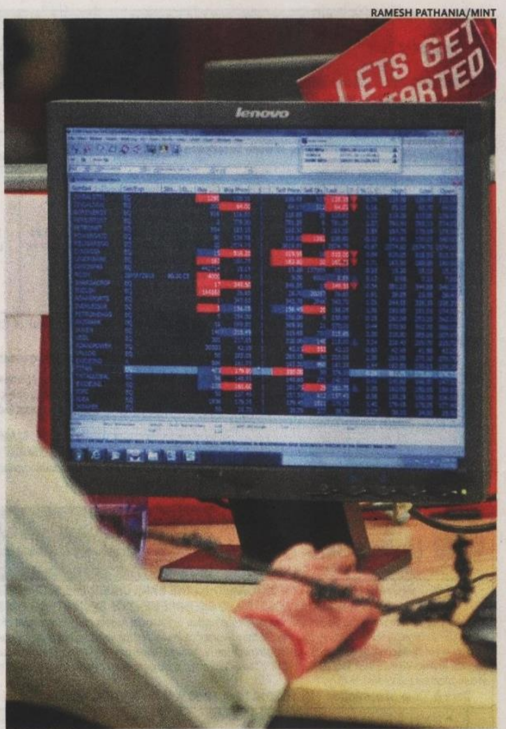

The year 2022 will mark 75 years of independence from British rule. If current growth rates sustain, it is expected that India will be the fourth-largest economy in the world by then. Our growth rate depends on infrastructure development, which in turn requires deep capital markets as banks may be averse to the risk or to the funding tenures.

Niti Aayog has prepared a blueprint with milestones to be achieved for the economic and social sector. Indian capital markets need to play a pivotal role in acting as catalyst.

Since the global financial crisis, capital market participants have been dealing with evolving regulation, increased operational requirements and steep regulatory costs.

In the next four to five years, the direction of the markets will primarily depend on:

- Structural changes, including consolidation, to existing capital markets participants' business models.
- Non-traditional players challenging the status quo.
- Innovations including extensive use of big data, artificial intelligence (AI) and machine learning. Participants will seek to reduce cost and create competitive advantages.
- Straight through processing and use of distributed ledger and blockchain technology.
- Pools of capital increasingly looking to reach out directly to consumers of capital, thereby lowering costs and increasing overall liquidity. Crowd sourcing and peer to peer opportunities, real estate investment trusts and infrastructure investment trusts gaining momentum.
- Investment management seeing impetus through robo advice, smart contracts and electronic trading.
- Successful resolution of applications filed under the Insolvency and Bankruptcy Code (IBC).

Regulators will have to respond to these challenges. In their facilitation role, regulators have to be forward looking and identify potential areas for market development.

An inter-regulatory working group set up by the Reserve Bank of India has recommended that an appropriate framework be introduced for "regulatory sandbox/innovation hub" within a well-defined space and duration where financial sector regulators will provide the requisite regulatory support, so as to increase efficiency, manage risks and create new opportunities for consumers in the Indian context similar to other regulatory jurisdictions. Creation of such a framework will be important for market development.

Regulatory attention will also need to stay focused on deepening and development of fixed income markets. The Securities and Exchange Board of India (Sebi) came out with a proposal to make it mandatory for large borrowers to source 25% of their incremental borrowings from the bond market. This could pose regulatory challenges in implementation because of structural issues including requirement to maintain a debenture redemption reserve and liquid funds.

Many of the delinquent Indian borrowers are now subject to the IBC, and the resolution of these could have far reaching consequences for the market.

Two developments that are also likely to impact regulations are product suitability and data privacy.

Product suitability entails an entire framework that requires grading of products in accordance with their inherent risk and categorizing clients on the basis of their capacity and ability to carry risk. Every mature market model must have robust suitability procedures and controls, and regulators are focusing on this.

Traditional players and fintech entities are heavily dependent on technology. These entities collect various personal and sensitive information and become the owners/custodians of such data. Sebi intends to examine aspects related to data privacy needs and facilitate the necessary ecosystem to encourage use of new technologies in capital markets.

Cybersecurity will also continue to claim the attention of regulators, who will have to respond to both opportunities and threats in the form of new regulation, requirement of audits and vulnerability assessments. They will also need to have market infrastructure institutions (MIIs) and put in place business continuity plans for timely recovery of operations in the event of a cyberattack. Sebi is planning a full cybersecurity review of MIIs that include all its cybersecurity advisories and a full list of threat vectors. In addition, a cyber-capability index is being developed to assess the cybersecurity preparedness and resilience of MIIs.

Another challenge is cost pressures and innovation compelling market participants to maximize outsourcing arrangements. Regulators will have to deal with the attendant risks, especially of cross-border outsourcing.

Regulators are also responding through ramping up their knowledge and with continued focus on investor protection and investor education. Corporate governance and enhanced disclosures will provide a fillip to their efforts. They have in place a comprehensive surveillance process and will build on this by using enhanced surveillance and investigation techniques, aided by AI and developing machine learning tools.

Regulators have begun to use technology drivers and new products to reduce time for fund raising through public issues. They are also tightening and enhancing penalty requirements for listed companies and for market intermediaries.

Inspection of market intermediaries will include more offsite data heavy analysis rather than on-site visits. These will be coupled with increased reporting requirements, rich data feeds and an integrated approach to supervision with data flow from exchanges and depositories.

As the markets deepen and develop, regulatory oversight and supervision must develop alongside. Integrating risk and regulation at an enterprise level is a significant challenge and the success of the capital markets and its participants will depend on this.

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