Global Capital Market – Divergence & Harmonisation

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1.0 Global Market Economy – Current Scenario
During last one-decade capital markets around the globe witnessed a series of developments in terms of its movements, volatility and capitalization. Despite the bearishness in the first half of 2003 due to war on terrorism, epidemic outbreaks, and economic sluggishness, the markets in the advanced economies received substantial benefits in terms of rise in Gross Domestic Product (GDP). For example, in high-income countries, the market capitalisation as a percentage of GDP was as high as 103.9%, where as in low-income countries it was at 18.3% (For India, it was 23.1% as against the world’s percentage at 90.7). A number of initiatives undertaken to attract cross border Investments through liberalised trade policies, globalised economic reforms, portfolio investments ranging from 24% to 100% of the paid-up capital with repatriation facility in certain cases were the prime factors of Asia now being in focus in the capital market. At present the Foreign Institutional Investors (FIIs) are concentrating in the emerging markets due to the fact that the rate of return on investment as well inflation rate in the emerging economies are slightly higher than the market to which they belong.

1.1 World Trade
The trade volume of the world is estimated at 3% for 2003, which is less the growth rate 3.2% for the year 2002. A sharp rise in oil prices has surged the commodity prices. Consumer goods prices in the advanced countries reached around 1.8% as compared to 1.5% in 2002 whereas it is 5% in developing countries for both of the years. Increase in the volume of trade is one of the potential causes for development of capital market of the economy. Ongoing discussions among the member countries of the World Trade Organisation (WTO) have to be taken into account for overall development and integration of global capital markets.

1.2 World Currency & Bullion Market
The sharp fall of US dollar as against the Euro, Sterling and yen have brought worries to the international investors in the US market and therefore there was lesser demand for US securities. This situation made US to start
investing elsewhere in the global market. As a result the Asian countries received substantial increase in the foreign exchange reserves. The evolution of Euro currency due to the co-ordinated efforts of member countries set a classic example of how common currency can stabilise the economic growth. In the bullion market, Gold is now commanding at its very high in its 13 years of track record and other metals like silver and platinum are showing an upward trend. Accordingly, the stock market will witness appreciable or adverse effect in terms of high volatility in the fluctuations of currency and the bullion.

1.3 World Stock Market Growth

Despite the international disturbances like Iraq war, SARS, Bird flu in Asia, terrorism threats and other natural calamities, capital market has shown steady growth in 2003. There was an increased demand for the Asian equities. The favourable liquidity conditions and macro environment factors accelerated further growth in Asian markets. Indian sensex rose to 80% outperforming all the major global indices. European markets have also shown remarkable progress. Currently factors are encouraging FIIs to think about the investment proposals in other countries. Another interesting factor in the global scenario is that the cross border capital flow is largely flowing from FII’s in the private sectors as compared to public sectors of developing economies. There are few countries in the world, which received higher turnover-ratio than India. The FII’s investment in India as on June 2003 was at US $ 17.39 billion with 509 registered FII’s. India stood 19th place in terms of capitalisation. In terms of turnover-ratio, India ranked 7th in position.

1.4 Emerging Economies

The year 2003 was the year for emerging economies. These economies undertook a number of initiatives in relation to their fiscal and economic policies, which have contributed, substantially to the stability of the world economy. The current fiscal year 2004 is a year of prospects and promises for higher economic growth and fruitful activity in the capital market. Lower interest rates, smooth flow of capital in market, growing trade volumes
would boost the economic growth rate of emerging countries. Following the South Asian crisis and taking structural measures thereafter, Asia is now holding about 1.7 trillion dollar of foreign exchange reserves and it has been predicted that the largest economies in 2050 would be China, India, Russia and Japan. China showed strong growth of indication with a real GDP at 8.7%. It has a market capitalisation of 220 billion dollars Nearly 20 out of 25 emerging country economies stock prices rose by 25% and amongst eight countries it was more than 75%. Further, currencies of these countries appreciated against the US dollar.

1.5 International Market: A comparison

<table>
<thead>
<tr>
<th>Particulars</th>
<th>USA</th>
<th>UK</th>
<th>Japan</th>
<th>Germany</th>
<th>Singapore</th>
<th>Hong Kong</th>
<th>China</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of Listed Companies</td>
<td>5.685</td>
<td>1.701</td>
<td>3.058</td>
<td>715</td>
<td>434</td>
<td>968</td>
<td>1,235</td>
<td>5,650</td>
</tr>
<tr>
<td>Market Capitalisation ($Bn)</td>
<td>11,052</td>
<td>1,864</td>
<td>2,126</td>
<td>686</td>
<td>102</td>
<td>463</td>
<td>463</td>
<td>131</td>
</tr>
<tr>
<td>Market Capitalisation Ratio (%)</td>
<td>113.0</td>
<td>126.2</td>
<td>47.0</td>
<td>35.4</td>
<td>114.7</td>
<td>271.9</td>
<td>40.9</td>
<td>27.4</td>
</tr>
<tr>
<td>Turnover ($Mn)</td>
<td>25,371</td>
<td>2,721</td>
<td>1,573</td>
<td>1,233</td>
<td>56</td>
<td>211</td>
<td>333</td>
<td>197</td>
</tr>
<tr>
<td>Turnover Ratio (%)</td>
<td>202.5</td>
<td>135.4</td>
<td>71.0</td>
<td>140.5</td>
<td>39.3</td>
<td>43.5</td>
<td>67.6</td>
<td>165.0</td>
</tr>
</tbody>
</table>


The above table in general reveals that in terms of market turnover ratio, there are very few countries, which have higher turnover ratio than India. The data on the number of listed companies in India as at the end of March, 2003 is 9,413 companies, whereas data of S & P took into account only 5,650 companies. Therefore, if the entire market were taken into consideration, the performance of position of India will be prospectively better.

Economies of the different countries are intensifically integrating by converging their legislations in accordance with the global economies. This is in order to reap the substantial benefits from trade and commerce. World is experiencing a new and ever expected fast growth with key economic factors like, low cost of transportation, minimum/absence of trade barriers, advancement information technology, greater mobility of human capital and painless capital formation. World markets are showing significant and
positive reaction to these developments for capital formation as well as for value creation to the shareholders. According to the survey of the World Federation of Exchanges conducted in 2002 on trading practices covering 42 exchanges worldwide focusing on six operational areas depicts the following interesting facts and practices:

- **Trading platform**
  - Electronic systems prevail in common and are typically order driven.
  - 32 exchanges have order driven system and only 2 stock exchanges have a floor system; 14 exchanges have introduced new trading platform in the past 12 months and 15 are planning to do so in next 12 months; About 86% of exchanges have platforms that include stock watch or real time error alerts; About 88% of exchanges have backup systems in place that are fully redundant.

- **Trading Products**
  - 33 exchanges reported negative to flat value growth over the last year but derivatives growth has been stronger.
  - There is significant growth of Exchange Traded Funds.

- **Order and Order Routing**
  - 12% of the Exchanges have the system that gives direct access for order routing; in 55% of the Exchanges, straight through processing is commonplace.

- **Execution**
  - Execution quality has generally improved with the electronic system
  - 49% of exchanges offer automatic execution of small orders; 71% of Exchanges offer opportunities for price improvement; Order processing times are typically less than a second.

- **Transparency and Information**
  - Global markets have become more and more transparent.
  - The majority of exchanges disclose substantial market information and disseminate them through variety of ways: 90% through data feed; 74% though Internet; 69% though trading system; 36% through special information system; 7% through satellite; 57% of exchanges
display the depths of all prices; 26% display depth for specific price level and 17% allow indicative quotes to be disclosed.

- **Other issues**
  - 76% of Exchanges operate with a self-regulatory framework.
  - Handling of regulatory functions; 40% of Exchanges are handling internally; 14% are by separate non-governmental entity; 21% are by Government regulator; 38% are handled jointly with a regulatory agency.

The analysis of the above table sets out broadly the framework needed for establishment of a single Global Capital Market. Before the need, there are divergent policy issues.

### 2.0 Policy Issues in Divergence (vs.) Harmonisation

Raising the offshore capital though Depository Receipts like American Depository Receipts (ADRs), Global Depository Receipts (GDRs), FCCBs and External Commercial Borrowings (ECBs) are becoming more common in the corporate sector around the globe. Many companies with their trans-national business dealings are listed in foreign stock exchanges to raise funds. Most of the countries permit FIIs to invest in all types of securities, including government securities and in restricted sectors like infrastructure. FIIs are enjoying full capital account convertibility for their investments. In India FIIs are permitted to invest in company through portfolio investment route up to 24% of the paid up capital. The stock exchanges are also becoming global, permitted to have trading terminals abroad. Trading platform of exchanges are also easily accessible through the Internet from anywhere in the world.

The respective central banks of the countries around the world have permitted two-way fungibility for Depository Receipts. Now a shareholder can either opt for conversion of his domestic shares in to Depository Receipts or vice versa. This process results in an improvement of liquidity in Depository Receipts market and elimination of arbitrage. In total, the necessity of harmonizing the capital markets around the globe has been emerged as a key driver for economic development of the country. The policy issues that have to addressed are:
2.1 **Risk:** It may be a legal, settlement or operational risk. To overcome these risks, there should be
- Transparent and clear legal basis in the relevant jurisdictions
- Confirmation of pre-settlement trade should be after trade execution i.e., preferably on T+0 but not later than T+1 or T+2.
- Rolling settlement should be adopted in all exchanges.
- The position of counter parties should be evaluated.
- Central securities depositories for making book entry of immobilised or dematerialised and transferred securities.
- Final settlement should be no later than the end of the settlement day.
- Operational systems should reliable and secure to overcome operational risk.

2.2 **Regulator:** Regulatory authority should be Independent having adequate powers, resources to function. It should also have powers of licensing, supervision, inspection, investigation and enforcement. It must have clearly defined responsibilities and highest professional standards staff. It should have an authority to access both public and non-public information with domestic and foreign counterparts.

2.3 **Regional Co-operation:** Co-operation amongst the member countries should necessarily exist to provide and share information for development of capital market.

2.4 **Listing authorities:** For evolving a complete single globalised capital market, it is important to remove the barriers and develop a single framework of window through which cross border collateral transactions takes place between member countries and the counterpart regulators. Just as international financial institutions like IMF/World Bank/UNCTAD and other agencies, a common listing authority should be established. The participating member countries should meet the desired global standards for listing the securities in any part of the world. Though it is a herculean task, the market will
become broader and deeper and at the same time the cost of raising capital will be lower.

2.5 Laws & Regulations. Multiplicity of laws and regulations would lead to confusion in the minds of investors and agencies who administer these statutes. There should be clearly defined objectives in statute for the agencies to maintain the consistency and to avoid regulatory overlaps and gaps. The market failures elsewhere in the globe are mostly due to the informational asymmetries, network barriers and the lack of confidence on the service provider. In order to design an efficient, effective dynamic single market, market regulators around the globe should address these issues.

2.6 Market Practices
- Trading mechanism: It should be screen based trading system; Orders should be matched on price-time priority; Transparent, trading platform accessible from all over country.
- Settlement cycle: Rolling settlement on preferably T+0 or T+2 basis.
- Settlement form: Mostly in electronic form.
- Transfers of securities: Securities should freely transferable. Transfers are recorded electronically in book entry form by depositories.

2.7 Standards of Technology The Internet, new digital technology, E-commerce can be effectively, efficiently combined and adopted to regulate transactions in stock market so as to ensure protection to investors.

2.8 Corporate Governance & Rating: The Corporate Governance is evolving as a role model and rating mechanism for evaluation of the listed entities. There is a need for developing a combined code of best governance practices focusing for the development of capital markets. Governance for central securities depositaries and clearing corporations should be designed to meet the expectation of public and for the promotion of objectives of owners and users. The Corporate
Governance rating should give due importance to address the issues relating to the pattern of shareholding, management processes and systems, board structure, stakeholder relationship, transparency, disclosure requirements and financial discipline.

2.9 Transparency & Disclosure Standards: Diversion of management with ownership and development of professionalism in corporate boards can be successful only if the highest standards of quantitative/qualitative accounting standards are set for ensuring the great transparency.

2.10 Fiscal & economic Policies Each member country of a single global capital market should frame their policies on reciprocity in matters relating to foreign institutional inflows, taxation treaties, and avoidance of double taxation relating to purchase and sale of securities. These policies in relation to FIIs should remain stable at least for a period of three years. This will gain the faith and confidence of the Investors’ in the market and markets will prosper.

2.11 Depository, clearing & settlements: A clearing corporation is an important constituent in a financial settlement and as long as it is centralised then the net obligations of each counter party and its risk cannot be estimated. Equally important is the management of fund clearing as a part of settlement process and therefore, it is that of prime importance that the global markets have to be interlinked and positively correlated a clearing corporation should be set up to undertake a clearing of Foreign exchange capital market transactions. Similarly depository participants should be accredited institutions for the transfer of securities. This will ensure better handling of transactions of securities without much of legal process of course subject to approval from the apex bank in each country.

2.12 Structure of stock exchanges: At present, the board of members of the stock exchanges have multi-faceted interests as a trading, clearing, and as Board Member. Stock exchanges in the country should be corporatised and demutualised to avoid such conflicting position. In
other words, in order to avoid the conflict of interest, the board members of the stock exchanges should not consist of the persons who are otherwise a trading or a clearing member. Stock exchanges should have the autonomy and consists of exclusive independent members who have sufficient knowledge of capital market.

2.13 Investors’ Protection: The protection of interest of investors requires consolidation of various statutes in to a single legislation and assigning its administration to one agency namely Ombudsmen for Investors’ Protection. There should be provision for setting up of investor clinics to redress grievances. Investors should be protected with Global Investor Protection Fund. Agencies similar to Securities Investor Protection Corporation (SPIC) of US should be established to monitor the investor protection. Investors’ education/awareness campaign should be conducted in co-ordination with all the regulators and NGO’s.

3.0 Framework for convergence
A new framework should be chartered out to ensure fairness and stricter compliance of legal and economic policies. Greater consistency between various rules of different sectors for a healthy competition should be maintained. The framework for convergence of Global Capital market primarily depends upon the following parameters:

3.1 Mutual recognition through MOUs: In order to encourage cross border investments, it is necessary that there should be a mutual agreement between member countries on the following parameters
  ➢ Agreement Regulatory & legal framework
  ➢ Agreement on harmonization of standards & disclosure
  ➢ Agreement on listing requirements
  ➢ Agreement for level playing field
  ➢ Agreement for prudential supervisions
  ➢ Agreement on mergers and amalgamations
  ➢ Agreement of competitive trade practices
Regional co-operation should also be ensured with memorandum of understanding (MOUs) amongst the member countries. Social, Economic and Geo-political issues should be given due importance while framing the MOU’s.

3.2 **New technology:** Trading should be facilitated by Internet technology. While addressing the Investor’s grievances, Internet should be used as a faster mode and with due care and diligence.

3.3 **Single Currency:** There shall be a need of uniform currency, which helps, in smooth flow of trading transactions and in determining the value of transactions. This also necessitates the formation of monitoring authority to regulate the volume and look after other controversial issues of the single currency system.

3.4 **Objective based legislation:** Statues to regulate the capital market should be based on objective rather than subjective. Legislation should significantly address the probable inter as well as intra national issues and be clear about the method of resolving the conflicts. There shall be regular tuning of the law to cope up with the latest developments in and around the global economy. There should be provision for adequate mechanism for implementing and governing the law.

3.5 **Standard setting process:** Accounting and auditing standards are very important in financial reporting aspect. Hence, there is a need for convergence of standards globally. All accounting and auditing standards setting agencies should agree upon the single-unified high quality standards. It will reduce the difficulty in comparison of financial statements and ensures the highest transparency of disclosures. At the same time, consistency in interpretation should be maintained to ensure transparency in financial reporting and to facilitate regulatory authority to oversight.

4.8 **Level playing field:** Adequate infrastructure should be created to ensure the smooth functioning of the market elements as a level playing field.
5.0 Conclusion:
The World is now concentrating towards the path of integration on various counts. It is therefore imperative for the capital markets around the globe to integrate on a common platform to share the resources in an efficient and effective manner. This process will have a long way to go, but nevertheless the fundamental principle is that for economic reforms, development and prosperity, capital market of every country cannot remain in isolation. It has to homogeneously blend and converge.

5.0 References:
1. BSE Annual Review of Financial Markets 2004
2. NSE Review of Indian Securities Market Volume VI 2003
5. World Development Indicators 2002, World Bank