Blueprint for Capital Markets in India in 2030

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1. Indian financial sector, including the capital markets, have shown resilience and maturity during the ongoing global economic and geo-political turbulence. The onset of COVID 19 in March 2020 was followed by the ongoing Russia-Ukraine war since February 2022, and an aggressive interest rate raising cycle adopted by the central banks across the world. The uncertainty continues.

2. To present any opinion about the blue print of capital markets in India in 2030, one has to make an assessment of where we stand at present, what are the projected growth figures, what are our aspirations, funding requirements of the domestic economy by 2030, and role of capital markets in fulfilling them.

3. By now, it is well recognised that amidst the existing global economic chaos, India is an oasis of stability and certainty. This is not just the Indian government's claim but also the views expressed, almost unanimously, by multilateral bodies of repute like the World Bank and IMF, and other credible agencies.

4. In fact, it has been quite a while since India emerged as an important actor at the world stage. Its current G-20 presidency and membership of many other important international bodies/groupings are shining examples of this. Today, no international forum, worthy of its name, can afford to not have India on board.

5. India is the fifth largest economy in the world and likely to become 3rd largest by 2028. India's annual exports are projected to grow to US $ 1 trillion by 2030. It has ambition of becoming a developed country by 2047.

6. As per its NDC declaration under UNFCCC, by 2030, India is committed to reduce emission intensity of its GDP by 45% from 2005 level, and achieve 50 % cumulative electric power installed capacity from non-fossil fuel based energy sources. For achieving the commitment of net zero emission target by 2070, India would need to cut energy intensity of GDP by about 5% annually. In addition there are several milestones to be reached by 2030 under 17 SDGs with 169 targets.

7. Additional investments are required for climate proofing the infrastructure and for funding the other activities relating to climate change adaptation. RBI's assessment of such an investment requirement until 2030 is Rs. 85.6 lakh crore.

8. Then the government has identified/set a number of near to medium priorities requiring market based financing/special focus, viz., national infrastructure pipeline, disinvestment of PSUs, asset monetisation, increasing manufacturing share in GDP, encouraging start-up ventures, etc.

9. All the above activities, commitments and aspirations have sizeable financing implications. While, traditionally, India has been a bank led economy, the capital markets would need to play a crucial and increasingly important role in the coming years. In fact this realisation has already set in, which is apparent from the growing heft of the capital markets in the domestic economy.

10. The annual amount raised through the capital markets (equity plus debt) averaged Rs. 9.6 lakh crore during the last five years, which is comparable to the incremental loans disbursed by the banks during the period. The AUM of MFs has crossed Rs. 43 lakh crore, which is over 30% of the outstanding cumulative bank loans.

11. What has also been realised is that the banks are not the most suited institutions for financing all types of investments, including in the infrastructure sector, wherein the projects are best funded through the market mechanism.

12. Capital markets comprise various segments and instruments. It may be useful to analyse the segment wise status and the possible way forward to meet the requirements of the economy by 2030.

13. Let us begin with the equities market in India. Equities market is well developed and liquid. Total market capitalisation of listed companies reached Rs. 291 lakh crore in June 2023, about 104% of GDP, and India ranked fourth in the world. The resilience of the Indian market during this tumultuous period has surprised many experts worldwide. The fact of the matter is the equities market in India has best in class regulation even as compared to the developed economies of the west.

14. Post COVID surge in individuals' participation in the market and increasing equity investment culture in the country is a recent phenomenon. The total number of demat accounts increased from 4.1 crore in March 2020 to over 11.5 crore at present, an increase of over 180% in a short period.

15. Mutual fund investments have also grown at an impressive pace. For instance, the AUM of Rs. 10.8 lakh crore at the end of March 2015 has increased to over Rs. 43 lakh crore at present, an increase by nearly 300%. Of course, there is much potential for higher penetration of mutual funds, waiting to be tapped, including in the tier-II and tier-III cities.

16. This increased domestic interest in capital market investments needs to be not only maintained but also further encouraged. Among other benefits, it is proving to be an effective countervailing mechanism against the volatility in FPI investments. Of course, we have a far way to go- as compared to the developed economies; we are still at a nascent stage. For instance, only about 8% of adult population in India invests in equities as compared to about 60 % in USA.

17. Going forward, the Indian corporates need improvement in their governance practices to attract investments; though, admittedly, much progress has been made over the period because of constant prodding by the government and the regulators. The Kotak committee set up by SEBI in 2017 made many recommendations on various aspects of corporate governance, which helped in beefing up the relevant regulations. There have also been some useful learnings from the international experiences especially from the OECD. That said, to meet the aspirations of becoming a developed country, the Indian corporates need to do much soul searching and demonstrate a responsible behaviour towards not only the shareholders but also all stakeholders.

18. The increase in institutional shareholding in listed companies in India is a good sign; but what is missing is their active and meaningful participation in the governance of those companies. They have yet to take their stewardship role seriously. Of late, the mutual funds have shown some progress but the insurance companies and pension funds are yet to get into the groove.

19. Auditors are important gatekeepers for ensuring that the corporates follow good governance practices. Their supervision needs much improvement; multiplicity of regulatory oversight over their functioning is not helping. Yet another area needing improvement and capacity building is the valuation methodology including that of start-ups and new tech ventures.

20. Now coming to the debt market. The corporate bond market in India is under developed and often illiquid. This is despite the fact that over more than a decade, the government and the regulators have repeatedly publicly pronounced the development of this market as a priority. The progress made in this regard so far is not enough. The absence of a deep and liquid corporate bond market may prove to be Achilles heel in the India's growth story going forward.

21. At present, 95% of corporate bond issuances in the country are concentrated in top 3 rating categories (AAA, AA+ & AA), and 97% of the trading is in these categories. Thus most of the issuers can't access the bond market. The situation is worst for the infrastructure projects. Such projects have low ratings, typically BBB, during the initial phase of their lifecycle. There is an urgent need to establish a credit enhancement mechanism for such projects. The much needed private sector investment in infrastructure sector is not likely to pick up without this.

22. Development of below 'AA' rated bonds market requires development of markets for 'repos', 'credit default swaps', 'interest rate derivatives' and encouraging growth of credit focussed Alternative Investment Funds among other measures.

23. "Unification of bond market", i.e., unifying the regulatory regime for G-Secs and corporate bonds is something which should be urgently initiated.

24. G-Secs have an overwhelming presence in the debt market in India. The pricing of corporate bonds is intrinsically dependent on presence of a continuous yield curve in G-Secs. The G-Sec market and corporate bond market are at present separated and follow different regulatory regimes. Unifying these markets would enable seamless transmission of pricing information from G-Secs to corporate bonds. Having the regulatory same regime for trading, clearing and settlement of corporate bonds and G-Secs will result in 'economies of scale and scope' leading to greater competition, efficiency and liquidity in the markets. This will also facilitate greater participation in bond market by individuals and non-institutions, who are more accustomed to dealing with the depositories and stock exchanges regulated by SEBI.

25. REITs and INVITs are emerging as important vehicles for asset monetisation in the real estate and infrastructure projects respectively. Though the SEBI regulations governing them were notified back in 2014, they gradually started appearing on the scene only from 2017 onwards. Many amendments made in the regulations over time especially those facilitating retail participation in publicly listed REITs and INVITs have helped in improving their popularity. As of March 31, 2023, they were holding assets worth Rs. 0.71 lakh crore and Rs. 1.77 lakh crore respectively. Going forward, for a country of India's size, there is huge potential for growth of these instruments.

26. Now coming to the required regulatory architecture for sustainable financing and ESG investing.

27. Globally, sustainable financing and ESG investments have emerged as subjects of great interest and significance. Increasingly, corporates are adopting higher ESG norms and the investors preferring such investments.

28. That said, sustainable financing is not a very well defined term, and to an extent is subjective in scope. There are no universally recognised or accepted ESG reporting standards and frameworks yet; though a number of international bodies are grappling with the idea. There is no consistency in disclosures and transparency of the methodology and rating process.

29. The absence of consistent and comparable ESG reporting standards and frameworks, as also of an agreed definition of sustainable financing, is likely to lead to greenwashing and miss-selling. This raises concerns about the potential risks to investor protection, transparency and capital allocation in

markets, among others.

30. SEBI has developed and put in place sustainability reporting standards for the listed companies in India. These standards viz. business responsibility and sustainability reporting standards (BRSR) have been finalized taking into account best international practices, domestic considerations and after wide consultation with various stakeholders including industry groups. SEBI's guidance note on the subject provides for inter-operability of BRSR reporting framework with international frameworks. As of now, SEBI regulations mandate compulsory reporting as per BRSR standards by top 1000 listed companies from the year 2022-23 onwards. Other listed or even unlisted companies could voluntarily adopt these standards.

31. SEBI board, in its meeting of March 2023, has also approved a policy on ESG disclosures and ratings, and framework for regulating ESG rating providers.

32. While we are in the process of firming up our own standards and frameworks, some international investors may prefer other globally prevalent norms and standards. In addition, with the passage of time, there could be possibilities of convergence of views on universally acceptable standards, which could be at variance with the ones adopted by us domestically.

33. Going forward, the climate change concerns are likely to further move the sustainable financing and ESG investment issues centre stage. The Indian corporates need to keep track of the developments and be prepared to meet the emerging regulatory requirements in this regard.