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Sustaining the market momentum

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Synopsis
The institutional infrastructure of the Indian securities market has improved dramatically over the past 15 years. But adequate attention has not been paid to the development of knowledge infrastructure.

A cadre of securities market professionals along with a base of well informed and educated investors is a key infrastructure for a healthy and orderly securities market. This knowledge infrastructure is as important as, if not more than, the institutional infrastructure for the securities market.

While the reform initiatives over last decade and a half have strengthened the Indian securities markets in terms of the institutional infrastructure making it one of the best in the world, adequate attention, however, has not been paid to the development of this knowledge infrastructure. Now that skill/knowledge deficit has been widely accepted as a critical bottleneck to the vaulting ambition of the nation, and financial literacy in India not among the best, it is high time to focus on this bottleneck to sustain and nurture the reform process.

While many markets (such as for agricultural produce) try to reduce the intermediation, securities market uses the services of a large variety of intermediaries. As this market gets increasingly integrated and complex, the intermediation process also follows the same route. In addition to the exchanges, depositories, clearing houses, etc., brokers, MFs, merchant bankers and so on form the additional layer in bringing the suppliers of funds and users of funds together for a variety of transactions. The quality of their intermediation/service determines the shape and health of the market. The authorities also need their help to initiate and implement reforms.

The intermediaries can do full justice to their task only if they have capability and incentives to do so. The incentive side is reasonably addressed by the rule of law: the regulations, code of conduct, fear of enforcement actions, etc. Enhanced efforts are, however, needed to build institutions and systems to improve capability. As of now, formal educational programmes on securities markets, particularly in the area of operations are rather limited. No academic course teaches how to maintain depository accounts, how to sell MF products, how to issue contract notes or how to trade, clear and settle trades on a stock exchange.

In the absence of any formal qualification, which equips a person to operate in the securities market, the market employs CAs, company secretaries, financial analysts, MBAs, who are trained for some other work, but can also handle the work in the securities market if they are given adequate training. But if there can be institutes and degrees for accounting, legal or medical profession, why can't there be institutes and degrees for securities profession?

Several countries with mature markets ensure quality of intermediation services through a system of testing and certification of persons working with market intermediaries. In the US, for example, as part of the registration process, securities professionals must pass an examination administered by the NASD regulation to demonstrate their competence in the areas in which they intend to work. This sort of arrangement ensures that a person dealing with financial products has a minimum standard of knowledge about them, market and regulations so as to assist the customers in their dealings, and bars ill-equipped personnel from providing intermediation services in the securities market. Such persons are required also to periodically update their knowledge and skill through continuing education programmes.

On account of low financial literacy, many investors do not have enough expertise to make the right investment decisions. They do not have enough understanding/time to comb through the plethora of information available from various sources, snowballed into an avalanche after the Sarbanes-Oxley, Clause 49, etc. They depend on the advice from others who may not be competent to render such advice and be accountable for the same. With growing intermediation (both type and number) different entities, irrespective of their competence, sell financial products to and advise the investors about various products under different regulatory purview. The result is confusion and insecurity in the minds of investors. There is a need to lay down a set of comprehensive regulations to govern the profession of "Financial Planners/ Investment Advisers" to address this issue and to enhance the confidence of the investors.

The Indian securities market shifted from merit-based regulation to disclosure-based regulation (DBR) formally in 1992. The DBR presumes that investors will make sensible choices or at least that they should have no one to blame for their mistakes but themselves. For example, the securities laws in theory permit issuers with no reasonable prospects of profitability to sell securities to the public, as long as their poor quality is fully disclosed.

Further, the marketplace often offers products with diverse features to meet specific preferences of investors. In such cases, if investors are not discerning, the DBR will not achieve its desired objective. Media provide easy access to information about the economy, the stock market and specific companies. An investor should be able to collect and use the right information. To facilitate this he needs to be educated and made aware of the market, products and participants, the care that he must exercise while investing, the basics of investment and his rights. A massive investor education and awareness initiative needs to be launched and sustained matching the size of the market and the market participants.

Sweeping changes are happening in the society. Increasing life expectancy necessitates people to do their financial/retirement planning prudently. The financial system is getting increasingly market-based and globally integrated involving complex products — where risks are being transferred by institutions to individuals. These markets offer huge choice in terms of products and individuals have to choose the best combination of products to meet their needs and take the responsibility for the same. In order to prepare individuals to take such responsibilities, the system needs to provide an arrangement which enables an individual to learn personal finance.

The US Congress has enacted the Financial Literacy and Educational Improvement Act of 2003. This Act has established the Financial Literacy and Education Commission and charged it with the responsibility to improve the financial literacy and education of persons in the US. India needs a similar initiative. It is desirable to introduce in a phased manner a subject on personal finance in the syllabus of schools and colleges. This would empower tomorrow's investors to make informed investment decisions and reduce transaction costs in an increasingly complex market place.

(The authors are civil servants. Views are personal.)