<u>The only thing constant is change (except the speaker)*</u>

Mr. Jena, Chairman, FEDAI, Mr. Ananth Narayan, Vice- Chairman, Mr. Sindhwani, CE, my banker friends, former colleagues from the RBI, ladies and gentlemen. First of all, let me congratulate FEDAI for the choice of venue for this year's conference -Budapest. A city which aptly symbolises the title of the conference, "The only thing constant is change".

2. During my last appearance at this august event, in Brussels in the spring of 2015, when still serving the Reserve Bank of India and which, at the time I had thought was my last address to you, I had indulged myself to take a walk down the memory lane to revisit certain significant milestones in the history of India's financial markets in general and forex markets in particular. In the span of just one generation, the forex market went from being highly controlled to giving market participants almost full freedom over their forex business. Do I hear murmurs of disagreement? Well, why not, for there is still a long way to go for our market to fully mature on every measurable metric that you can think of, be it size, liquidity across tenors, products, participants etc. I will, however, choose to respond to such murmurs by quoting a handy adage- Rome wasn't built in a day. Don't forget that ever since the government embarked on a course of irrevocable economic liberalisation in the early 1990s,

we have stayed the course despite numerous political and economic crises, both at home and abroad. Through this challenging period of implementation of the new liberal economic agenda and which I was able to both witness and at times even directly participate in, the Reserve Bank played the roles of the instigator, enthusiastic supporter, trusted adviser, and at times even the fall guy! Above all, RBI was there when needed, to paraphrase the words of former RBI chief, Governor Subbarao. At times, this trait of infallibility manifested itself, had the context not been so serious, in almost comical manner.

3. Let me illustrate this with an episode from Jairam Ramesh's 2015 book on the 1990s economic reforms, "To the brink and back". Ramesh writes that P V Narasimha Rao, the then prime minister was opposed to the idea of Rupee devaluation because of its political risks. However, Manmohan Singh, the finance minister, was keen on a two-stage devaluation. The idea being that the first move would have tested the markets and the second one would have helped stabilise the currency closer to a more desirable level. The first stage of devaluation on July 1, 1991, however, evoked strong political reaction including from within the ruling party making PM Rao even more uncomfortable with the idea. In the early hours of July 3, Rao

called up Singh to ask him to stop the second devaluation. Singh argued
with the prime minister, but gave up in the face of Rao's insistence. In the normal course, the second stage of devaluation should have been aborted after the prime minister of the country had desired the process to be halted. Singh made a call to the RBI at 9.30 am asking for the second stage of devaluation to be held back only to be told by Deputy Governor at that time, C. Rangarajan that the devaluation had already been carried out a little earlier at 9 am, which is the usual time of opening of the forex market. Talk about sticking to protocol! Let's take a more recent example- the introduction of covered options in 2016, a proposal that was first mooted in 2003 at the time
of introduction of USD-INR OTC options but took more than a decade to implement. Still there were several critics arguing that the time was not ripe for this product etc. In my view, and as the devaluation episode above illustrates, it is difficult if not impossible to perfectly sequence market reforms. The art of policymaking is essentially trial and error and as long as any duly examined policy measure is a step forward, and is able to withstand the test of time, it should be applauded.

4. While everyone would agree that change is the only constant, from a market perspective it begs the question whether all changes are always positive for the markets. In today's scenario, unconventional thinking is what is called for by all, for the markets we trade and are so passionate about are being buffeted by unprecedented forces, two of which and certainly the more significant ones viz., “Fintech” and “re-emergence of protectionist forces” are the subject matter of the panel discussions later in the day. I would like to share my broad thoughts on these and leave it to the panel members to react and provide their own flavour so that this distinguished audience is able to understand and appreciate the issue from all perspectives. First, Fintech. During my last several years in RBI, along with forex, the other major area under my purview was that of payment and settlement systems. More often than not, the two complemented each other and it allowed us to address the issues at hand in a holistic manner. E.g. market participants like CCIL, which are authorised under the PSS Act are active providers of trading platforms in forex instruments and are also authorised as Category-III dealer under FEMA, 1999. But fintech is a creature that, I dare say, is not amenable to traditional and time tested statutory and regulatory frameworks. Coupled with the ever-growing menace of cyber-attacks, it is imperative that we, and the regulators naturally have to

assume the lead here, move quickly to tackle the negative aspects of fintech before it assumes *Frankenstein-esque* proportions. In July, this year the Economist carried a story on the ballooning hidden online market for drugs or as it is better known, *the dark web*. According to the article, the lynchpin behind the success of the dark web is fintech and particularly the bitcoin, which is the means of payment in this online underworld. The pros and cons of fintech and blockchain technology in particular, the prospects of bitcoin as a challenger to conventional fiat currency and related themes have been debated *ad nauseum* in the popular and financial press and I will not touch upon them here. However just a word of caution. Let us not equate block chain technology with Bitcoin alone. Blockchain technology has huge prospects in the financial sector and many countries are starting study this in detail. Harnessing fintech profitably requires both sophisticated computer and financial engineering skills. We need to address the skill gaps in our industry lest we are overtaken by market forces, especially the ones outside of the reach of our laws. E.g. current regulations In India require rather painstaking verification of paper evidence by authorised dealer banks before allowing their customers to put through forex transactions arising out of legitimate business dealings. Let's think for a moment. In future, customers may access "dark web" platforms to carry out their transactions without anyone knowing. Our industry needs to

ensure convergence of both types of engineering skills alluded to above to effectively address the challenge of fintech. It is well known that foreign banks and more recently, few private sector banks have been the dominant players in marketing of derivatives while the public sector banks have been dominant on the credit side. One reason for this disparity is the distribution of skills between the two markets. Foreign and private banks with more flexible compensation systems have been able to attract the high-end talent required for marketing of derivative products. Doubtless, they will leverage the same flexibility to make the most of fintech opportunities as and when they become available. It is my fervent hope that this time around public sector banks will not be found wanting and will proactively lobby with their primary shareholder i.e. the government to accord them the necessary powers in this regard so that we can actually have a level playing field in banking. For one thing is clear- before we know it, the business of banking and marketing of financial instruments will rapidly acquire characteristics of sophisticated computer and mobile technologies and the amount of paper involved will diminish equally rapidly, regulations notwithstanding.

5. Let me now discuss how technology has ushered in changes to the market structure in developed markets. The issues have been well summarised by Simon Potter of the Fed Reserve in one of his

speeches. As per the BIS Triennial Central Bank Survey 2016, the trading in foreign exchange markets averaged $5.1trillion per day in April 2016, down from $5.4 trillion in April 2013, a month which had seen heightened activity in Japanese yen against the background of monetary policy developments at that time. For first time since 2001, spot turnover declined. The data clearly showed that role of "other financial institutions" is on the rise accounting for over half of the total turnover. This expansion in participation by non-dealers in the foreign exchange market has been facilitated by the increased ease of entry into the market, attributable to an expansion in the number of technology enabled execution platforms and services, which, have reduced trading costs, increased the speed with which transactions take place, and improved transparency. Electronic trading activity in foreign exchange markets, as well as in other markets, has been accounting for major portion of transactions across markets.

6. Technology besides widening participation has also been changing how participants engage the market, through both single- and multi-dealer platforms. In the past, institutional customers could engage the market only by calling their dealing bank, but the marriage of technology and prime brokerage—the bundling of investor services, such as trade execution, settlement, financing, and custody—has enabled direct access to the inter-dealer market.

7. The expansion of both the universe of market participants and the infrastructure to support execution has brought many positive benefits to the market and global economy, but we should also be mindful of potential costs. In particular, it is important to consider the implications for the overall integrity of the market, which relies on the ability of market participants to confidently and effectively transact at prices that reflect available market information. While one can appreciate the positive influence that technological changes have had on market functioning, including narrower bid-ask spreads, it is unclear how these changes may affect the broader price discovery process or liquidity of markets overall. Technology allows market participants to better connect across potentially fragmented execution options, but has the central price discovery mechanism emerged stronger, and is liquidity as resilient? This is the question that global markets are trying to find an answer to. Further, dealers increasingly are internalising customer flows—that is, matching their clients' buy and sell orders in-house rather than executing them through the open market. But what does this do to the quality of pricing in the open market?

8. Now let me turn to the second issue that of protectionism. What could be its effects as far as India is concerned? India for several years has acted as a sourcing pool for global companies and

banks. Indian dominance in Silicon Valley and other such technology centres as also the financial sector is of course well known. I mention these aspects of our workforce in the context of the gathering clouds, though at times scattered, of the protectionist policies of some major developed economies. While we can discuss the root causes of this policy shift at leisure-obviously domestic political compulsions play a huge role, it is a cause of both concern and potential opportunities for us. Media reports indicate that there has been a drastic decline in the number of H1B visas available to Indian IT companies in recent months and many existing visa holders are not sure if their visas will be renewed. Further, major Indian IT companies are planning to augment their recruitment in host countries rather than ship Indian engineers to offsite locations. All this means that in near future we could have access to experienced and sophisticated computer and IT engineers returning to India or considering such a move. The present Indian financial landscape offers mouth-watering opportunities, from marketing of financial products to sophisticated data analytics to solve the NPA problems. Economic protectionism is not a new phenomenon. We ourselves became rather astute practitioners of such policies during the period from 1960s till 1980s. But we overdid the astuteness and it brought us to the brink of economic collapse in 1991. Faced as we are today with protectionism originating from the so called lands of free market

economics, let us, however, not mimic our past policies by responding with our own homegrown protectionism. Instead let us meet the emerging protectionist threat head-on and make the most of the opportunities that it might throw
up.

9. Back home, in recent times, RBI has come out with measures to give greater flexibility to non-residents to enter into derivative positions with AD banks in India to hedge the currency risk of their Indian subsidiaries. Another draft announcement pertained to allowing derivative positions without requiring verification of documents but subject to certain safeguards. In my view, both are steps in the right direction as they will increase the set of participants in our market and also reduce the burden of compliance on the banks and customers alike. But I would be failing in my duty if I do not flag some areas of concern arising out of government/regulatory actions or positioning. The most important one relates to some of RBIs recent decisions on rupee borrowing. Having been a part of the decision to allow rupee borrowings and bonds let me articulate this a little. The original intention behind the move was laying out a path towards internationalisation. It was believed then that as long as we avoid the "original sin" we should not be putting micro restrictions on rupee borrowing. But then the thought process has apparently

changed within the RBI. To my mind bringing back end use restrictions, and keeping a cap on such borrowings both to bring about parity with foreign currency denominated debt is comparing apples with oranges given that domestically issued debt where foreign investors can participate has no end use restrictions and interest rates are market determined. In a nutshell, allowing Indian companies to issue Rupee bonds overseas was a powerful market signal of our liberal policy stance and a tangible harbinger of Rupee internationalisation. Reversing this path breaking decision might just send out a message of us retreating from the markets.

10. Given the diversity of the audience all of whom are not front desk dealers, let me flag some important FEMA issues as well. It was with great fanfare that the country ushered in FEMA to "facilitate" forex transactions rather than pursue the FERA aim of "conserve". But sadly, we are yet to achieve this given the multiplicity of micro regulations. Let me take a few major areas to amplify. Take the FDI area. Even though the flows continue to be robust, we need to be conscious of the fact we are competing with rest of the world to attract the pool of investments. In such a scenario, regulations will have to be minimal, unambiguous and investor friendly. When regulations focus to prevent outlier cases then we end inconveniencing the majority. Today the extent of enquiry that goes

into inflows needs a relook, in my view, if they are received through the banking channels from FATF compliant countries. Second, while simplification of pricing guidelines has been achieved, why should FEMA continue to prevent two consenting parties agreeing to a price in today's liberalised regime? If the worry is on account of ECBs masquerading as FDI or assets being transferred through off market pricing, is it not better to address them separately than through FDI pricing? In this context, while one can understand RBI's concern about deferred payments as it defers inflows, applying this even when the resident is buying out the foreign investor is difficult to comprehend as this was not restricted even under FERA days. It is hoped that at least after a few high-profile arbitration rulings that went against the FEMA regulations, government and RBI would come out with more pragmatic regulations. Let me flag one more area viz. Indians investing globally. FEMA has to enable an Indian resident to compete with a Chinese or a Mexican or a Brazilian for instance. But we continue to have all sorts of restrictions whether they relate to multi layered structures or overseas Indian companies investing back into India out of genuine surpluses generated abroad (dubbed as round tripping) or for that matter what is permissible under the LRS for undertaking overseas investments. We seem to be attempting to address all sorts of concerns be it tax evasion, or

money laundering through FEMA which creates unnecessary complications. I am sure RBI will address all these issues in its own inimitable way. Earlier the better.

11. Two issues of international relevance before I conclude. As this audience is well aware, the foreign exchange markets in several parts of the world have recently been rocked by broad, unethical misconduct. A recent series of investigations in a number of countries established that serious misconduct and collusion had occurred in the foreign exchange market. The investigations led to a string of regulatory actions and fines against some of the largest banks active in this market, and criminal pleas across multiple jurisdictions. These developments have resulted in damage to the integrity of the global FX market—damage that will not easily be undone. The resulting loss of the public's faith and trust in this critical market comes with a cost: Let's recall that it is ultimately the public that stands to lose from an FX market unable to play its vital role in the global economy. Among several initiatives to ensure ethical conduct, mention must be made about the Global Code of conduct issued by the BIS in May this year after two years of work. RBI was part of its FXWG (Foreign Exchange Working Group). It has strongly supported the principles of good practices within the Code and will be engaging local market

participants to promote adherence to the Code. The regulators, including RBI have agreed to adopt the Code first by signing the Statement of Commitment. The code is a set of global principals of good practice in the FX market and is intended to promote a robust, fair, liquid, open, and appropriately transparent FX market. It is voluntary in nature and does not impose any legal or regulatory obligations. It will be morally binding on those market participants who adopt the code. The code is organised around six leading principles, viz. Ethics, Governance, Execution, Information Sharing, Risk Management and Compliance, Confirmation and settlement process. Since Mr Parvin Gupta is talking on the subject, I shall not dwell into further details.

12. Once fully implemented, the Code will bring in a lot more ethics and transparency in the market and help in erasing whatever little mistrust might occur between the participants. Reserve Bank, I am sure will direct adoption of this code in the Indian markets sooner than later. May be FEDAI should take the lead in doing this.

13. As I conclude, I hope FEDAI continues to be closely engaged with the RBI in the process of market reforms as it has been in the past. On my part as a former RBI-ite and a keen tracker of markets, while it is not my intention to second guess the moves of the

regulator, I do wish that we continue on the path of calibrated market reform, a crisis or two notwithstanding, for we need to provide the necessary market friendly policy environment to support the higher economic growth trajectory which in turn is critical to meeting the aspirations of our young and dynamic workforce.

14. I thank FEDAI once again to have invited me to address this august gathering in this lovely city and share my thoughts on some of the challenges and opportunities looming over our market horizon

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