Budget: No 'big bang' but progress for financial sector

By Sawant Singh and Aditya Bhargava, Phoenix Legal

PHOENIX LEGAL

New Delhi
Second Floor,
254, Okhla Industrial Estate
Phase III
New Delhi – 110 020, India
Tel +91 11 4983 0000
Fax: +91 11 4983 0099
Email: delhi@phoenixlegal.in

Mumbai
Vaswani Mansion, 3rd Floor
120 Dinshaw Vachha Road
Churchgate
Mumbai – 400 020, India
Tel: +91 22 4340 8500
Fax: +91 22 4340 8501
Email: mumbai@phoenixlegal.in

With the growing integration of India into the global economy and with the sheer size of the Indian economy, the country's budget speech has become a keenly anticipated event. Rating agencies, multinational companies and global financial institutions now join Indian companies, financial institutions and individuals in trying to read the "tea leaves" and predict policy changes in the coming budget. The buildup to the 2015-16 budget speech on 28 February was particularly strong as this was the current government's first "full" budget and was expected to be a cornerstone of its growth-oriented policies.

Financial sector reforms

The budget included the anticipated roll-out of the goods and services tax (GST) from 1 April 2016, a much awaited reform that will replace the current chaotic indirect taxation structure with a single tax. The implementation of GST would reduce the cascading effect of cost on goods and services across India and would also have the added benefit of creating a common market for goods and services across India. Indeed, this has been touted as a pan-India "free trade" deal. However, the budget was short on details of how GST would be implemented, a notable omission considering that GST will require the buy-in of all the states as well as constitutional amendments.

To improve liquidity for micro, small and medium-sized enterprises (MSMEs), the finance minister announced that the government was establishing an electronic trade receivables discounting system to finance trade receivables of MSMEs. The Reserve Bank of India (RBI) in December 2014 had released guidelines for setting up and operating such a system, based on public comments received on a concept paper issued by the RBI in March 2014. Establishing such a system appears to be a popular idea and the budget speech may provide the impetus required for its roll-out.

A notable development was acknowledging the failure of the Sick Industrial Companies Act and the Bureau for Industrial and Financial Reconstruction established under it to ensure a "workout", i.e. out-of-court corporate debt restructuring, for troubled borrowers. The finance minister identified bankruptcy law reform as a key priority and promised to introduce a comprehensive bankruptcy code in 2015-16 that will "meet global standards and provide necessary judicial capacity".

Landmark change

Despite the lack of "big bang" reforms, the budget proposed a landmark change. Non-banking financial companies (NBFCs) had been clamouring and lobbying for a long time for parity with banks in access to the recovery mechanism established under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. With the RBI recently introducing regulatory changes to curb "shadow banking" and the regulatory arbitrage previously enjoyed by NBFCs, support for such parity grew. In the budget speech, the finance minister announced that NBFCs with an asset size greater than ₹5 billion (US$80 million) would be considered for access to the recovery mechanism under the act.

He also proposed further systemic reform for the financial sector, through the establishment of a Public Debt Management Agency to manage India's external and domestic borrowings. In addition, the budget included a proposal to merge the Forward Markets Commission and the Securities and Exchange Board of India to strengthen the regulation of forward transactions in commodities.

The establishment of a "sector-neutral Financial Redressal Agency" to redress grievances against all financial services providers and the introduction of an "Indian Financial Code" to consolidate and replace the plethora of existing financial-sector legislation also received notable mentions.

To streamline foreign investments, the budget proposed to stop distinguishing among various categories of foreign investment and introduce a composite cap. In a move to provide a fillip to investment, the budget also proposed allowing foreign investment in alternative investment funds (AIFs) and providing "pass-through" status to category-I and category-II AIFs.

To curb India's traditional appetite for gold, which partly accounts for the widening fiscal deficit, the finance minister proposed some innovative ways to monetize savings in gold. This included the introduction of a "sovereign gold bond" that would carry a fixed rate of interest and could also be redeemed for cash as per the prevailing value of gold.

Like most Indian budgets, this one has received mixed reviews. From a holistic perspective, it can be concluded that while the budget itself did not deliver any "big bang" reforms, it appeared to have a strong focus on preparing the field for what could be the next phase of sustained growth for the Indian economy. The proposals for the financial sector were well received by domestic as well as foreign market participants, and if implemented, these could be a game-changer.

Sawant Singh is a partner and Aditya Bhargava is a principal associate at the Mumbai office of Phoenix Legal.