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Opinion

MONDAY, APRIL 17, 2017

BRIDGING THE GENDER DIVIDE

Arun Jaitley, Union finance minister

When you speak in terms of (gender) parity... conceptually, we provided for parity (in the Constitution). We also provided for some affirmative action ... But there were always challenges.

Forget the naysayers, DigitalPay is doing well

Most focus on the fall in post-December card volumes, but keep in mind the near-doubling in a year despite this

WITH OVER SEVEN lakh merchants, especially in the countryside, already in a position to accept payments via Bhim-Aadhaar and a plan to triple this over the next six months, prime minister Narendra Modi couldn't have imagined a better start for digital payments for those who don't have smart-phones or shop in outlets that don't have PoS machines. How much of a fillip this will give to DigitalPay remains to be seen and, in the case of the poor, will also depend on how fast the government scales up its direct benefits transfer programme—only when the poor have a steady stream of inflows into their bank accounts can they use Bhim-Aadhaar to make direct payments into the shopkeepers' bank account. Though the value of the transactions are different and Bhim is not a wallet, by way of comparison, India's most successful wallet—PayTM—boasts of 8.5 lakh merchants and 150 million customers; once the government is able to ensure all bank accounts are linked with Aadhaar, potentially Bhim-Aadhaar's user base can run into 40-50 crore.

What is important, however, is that even before Bhim-Aadhaar, India's digital payments revolution was doing very well, and certainly not faltering as many have been trying to portray. While doing so, most look at the fall in the use of debit/credit cards for payments after their December peak of ₹89,180 crore—as re-monetisation rose, and the banks started dispensing more cash, the argument went, Indians went back to using cash. It's certainly true that card usage fell—representational data for March shows a partial recovery though—but what matters is the increase despite this. Even after falling to ₹64,290 crore in February 2017, card usage was still 1.9 times what it was in February 2016. IMPS, or instant money transfers using internet banking, rose 2.9 times to ₹48,220 crore over the same period and mobile wallets by 3.1 times to ₹6,910 crore. By no stretch of the imagination can this be construed to be evidence of Indians going back to using cash in a big way.

More than this, the government's response in putting together a viable cashless/less-cash plan has been quite amazing, even when compared with the speed/innovativeness normally associated with the private sector. Not only did the public sector NPCI put together a Bhim-Aadhaar solution for those without access to smartphones, it came out with a common BharatQR for Master/Visa/RuPay cards which, by virtue of the fact that it could be used in smartphones, increased the number of 'virtual' PoS machines by 220 million compared to the 2.2 million physical ones; in the early days of demonetisation, ways were found to quickly defray transaction costs to ensure the digital revolution didn't get stalled. The benefits will be quite large, going by a recent Visa study which examines the costs of holding cash—including the issue of security while handing large amounts of cash—and puts this at as much as 1.7% of GDP each year. The brunt of this is borne by the poor who lose out on bank interest by not keeping their money in bank accounts—indeed, in the case of small merchants, the ability to show digital transaction trails will now enhance their ability to get lower-priced loans from formal finance channels. Even those opposed to demonetisation will welcome the push it has given to DigitalPay.

More captives for EPFO

That's the impact of raising the EPFO ceiling wage

ONCE THE GOVERNMENT raised the minimum wage, it was not surprising the Employees Provident Fund Organisation (EPFO) began clamouring for a hike in the ceiling wage beyond which monthly contributions to EPFO are not mandatory—most organisations, though, deduct EPFO for even higher-paid employees as labour bureaucrats seem to feel it is mandatory. So, after raising the ceiling from ₹6,500 per month to ₹15,000 in 2014, this has now been raised to ₹25,000. Immediately, 50 lakh more employees in the organised sector will be forced to have 24% of their salaries mandatorily deposited with EPFO. Given the virtually non-existent social security India has, it is not surprising the government would want to get more people to save in EPFO-like retirement schemes, but it needs to look at the costs of doing so. Indeed, it is the high costs of the EPFO that made finance minister Arun Jaitley, in one of his budget speeches, talk of how the EPFO was said to have hostages, not subscribers—such is the EPFO's power, though, Jaitley has not managed to free the hostages to allow them to invest elsewhere.

While, till recently, the EPFO didn't even invest in the stock markets, it charged a fee that was so high—3.3% of monthly contributions—it made it the world's most expensive mutual fund. In FY15, it earned ₹4,904 crore on this account and even if you assume all of its ₹1,766 crore expenditure was *kosher*, it ended up with a surplus of ₹3,137 crore. Other government-run schemes, like the Employee State Insurance, similarly make huge surpluses from employees who have no option but to subscribe to them—the ESI's payout ratios are in the 45-50% range as compared to over 90% for most private insurers, indicating just how much extra premium it charges. Thanks to EPFO-ESI type of deductions, the Economic Survey 2016-17 points out people who earn under ₹20,000 a month receive only 55% of their salary in hand—this huge difference between *chitthiwali* and *haathwali* salary makes unorganised sector employment more attractive. Ironically, it is to eliminate this distortion that, for instance, the government came out with a package for the apparel industry as well as for some others that allowed workers to escape the mandatory EPFO tax. So, on the one hand, the government plans several carve-outs to allow workers to escape from the EPFO, and on the other, it makes it more difficult for workers to escape by raising the EPFO ceiling. The government's left hand, as the old saw goes, doesn't know what its right is doing.

Uprooting TOBACCO

Any serious effort to tackle tobacco has to begin with the right crop substitution strategy

THE WHO ESTIMATES that nearly 45% of all cancer cases in Indian males and 20% in females are related to tobacco use. So, on the face of it, the government and some of its organs investing in tobacco companies would seem irreconcilable with the public health agenda's anti-tobacco focus. That is what perhaps led to the filing of a PIL with the Bombay High Court against the Union government, the Insurance Regulatory and Development Authority of India and five state-owned—the irony underlined—life insurance companies for investing in tobacco companies, including ITC and VST Industries. Whichever way the eventual ruling in the matter goes, the problem perhaps is much larger than the government investing in tobacco businesses.

Getting the government to put its money where its mouth is should perhaps begin with ending tobacco cultivation in the country—a high-stakes move given the economics involved. Though tobacco is grown on just 0.46 million hectares of largely poor-quality soil in the country, India is the second-largest producer of tobacco by volume and remains a major exporter. The bigger question is of livelihoods—nearly 36 million Indians are dependent on tobacco income. To wean them away, the government must encourage a transition to a substitute crop. It could start with disincentivising the crop and instead give direct support for an alternative. A WHO feasibility analysis for six tobacco-growing countries (India wasn't included) argues that while several cash-crops including banana would be a fit in terms of crop suitability for specific soil types, the challenge will be of potentially smaller market-shares and the difficulty of entry into an existing market. It highlights the Canadian experience to emphasise the role of non-farm opportunities as part of the dialogue on crop diversification. If India must move away from tobacco, it has to start with the right crop substitution strategy.

LONG-TERM LENDING

THESE BANKS WILL BE STARTING WITH THE HANDICAP OF LENDING TO THE NON-RETAIL SEGMENT AND TAKING ON HIGHER RISK AS THE TENURE OF THE LOANS WOULD BE LONG

Wholesale banks a must for financing infra needs

MADAN SABNAVIS
Chief economist, CARE Ratings

THE CONCEPT OF a Wholesale and Long Term Finance (WLTF) bank is part of the scheme of differentiated banks that has been in the news of late. The creation of payments and small banks was also part of this agenda. One is not sure if these banks will make a major difference, but those promoting the same evidently have their plans in place. A corollary in the success of these banks would be that commercial banks have not been successful in spreading financial inclusion and have not harnessed use of technology. In fact, the regional rural banks and structure of cooperative banks have to be critically analysed in this context as they have not delivered.

Now, the WLTF bank concept is not really a new one as there was the rather strong and convincing structure of the Development Financial Institutions (DFIs) that existed from the 1950s to the beginning of the 21st century. The 3 institutions, IFCI, ICICI and IDBI, can be credited with building India by providing long-term finance to industry. The system was straight-forward, one where they were able to get funds at concessional rates and on-lend to industry. With the onset of financial liberalisation, this relation was severed and they had to borrow at market rates. This also meant that their lending rates had to be increased and the model ceased to be viable.

The result was that these DFIs got themselves converted to universal banks under much fanfare and both ICICI and IDBI became banks through reverse mergers with their commercial banks outfits. The main advantage was that they got access to current and savings deposits which accounted for around 35% of total deposits; that helped lower the cost of funds. But, given the structures of assets and liabilities, there were bound to be tenure mismatches when lending to infra projects or long-term projects.

More recently, IDFC has gotten converted to a commercial bank, and IFCI, too, is keen on doing the same. Quite clearly, it does appear that the era of DFIs is on the way out and those that remain are EXIM, NHB, NABARD and SIDBI, which are actually refinancing organisations. How do WLTF banks fit in now?

The purpose is to provide long-term finance exclusively to corporates, including infra companies and SMEs. These banks will do only wholesale lending, keeping retail loans to the minimum. Funding cannot be through regular deposits, but it is mentioned that there can be current deposits besides term-deposits of high value. They can issue bonds and can also subscribe to the same which are issued by corporates and hence play the role of market makers. They can also go in for borrowings from banks, CDs or securitisation etc.

Do we require such banks? The answer is "yes" as the present system cannot quite handle the demand for such funds. Commercial banks, including PSBs, have preferred to lend to the retail segment where the delinquency rates are low. Therefore, having banks which focus on only long-term lending will be very useful and add a new dimension to lending as banks continue to focus on short-term lending.

Will a public purpose be fulfilled in case WLTF banks come in? The answer again is "yes" as these banks will fill the gaps that exist in the system today. The demand for funds is high, given investment rate is quite low at 27%. If it has to be pushed up to 35%, alternative avenues need to be sourced as banks, ECBs and the debt market have their limitations. This new genre of banks will definitely add value.

How viable will they be? Once the WLTF matches the tenures of its assets with liabilities, there will be a good fit between the two. At present, AAA-rated bonds come with a rate of between 8-9% with the lower-end being reserved for public-sector companies. AA-rated bonds can range between 9-12%, while a higher rate has to be paid in case the rating is in the A category. Therefore, WLTF banks will need to get a very good rating to get a borrowing rate of 8-9%.

The banking system operates with high spreads between deposit and lending rates. Today, the spread between the base rate and one-year deposit rate is 275 bps. In FY16, the difference between cost of deposits and return on advances was 330 bps. Cost of funds was around 6%. With WLTF banks procuring funds at 300 bps higher than the banks, adding 330 bps spread will push up costs for the borrower. Will companies be willing to pay this much, especially when they can borrow directly from the market?

> The demand for funds is high, given investment rate is quite low at 27%. If this rate has to be pushed up to 35%, alternative avenues need to be sourced as banks, ECBs and the debt market have their limitations

For WLTF banks to succeed, several options need to be explored. The first issue is how to lower the spreads for the WLTF bonds. Having bricks-and-mortar structures would add to costs and hence the option of being primarily an internet based bank can be considered. Second, the WLTF banks can be made to apportion lending activity across both credit and debt markets. A 50-50 division will be useful as they can lend directly in the bond market for bonds which will be higher-rated. This will also be the preferred route for higher-rated companies. The balance lending should be based on collateral with insolvency laws in place. Also, RBI should focus simultaneously on credit enhancements to be provided by banks on such bonds which may be subscribed by the WLTFs.

Third, the WLTF banks should be freed completely from CRR and SLR obligations. The CRR is a disincentive while SLR will make them gravitate towards G-Secs. Fourth, RBI can set tenures for their lending, i.e., not less than five years or such a norm, but should give the freedom to lend to any sector. Bringing in priority-sector-like norms will impede their activity.

It should be remembered that WLTF will be starting with the handicap of lending to the non-retail segment and taking on higher risk as these loans would be of a long tenure. Focusing on infra projects and term-lending makes FIs more vulnerable to NPAs and hence, prima facie, the last decadal developments are a dampener. In short, there should be few inhibiting clauses in the terms of engagement for these banks, or else potential promoters would be at a disadvantage. An issue which should be kept in mind while giving permission is that all banks—including private sector—ones have faltered on asset quality when such long-term lending is concerned. How can one be sure the story is not repeated here?

WLTF banks could be a useful way of channelling funds to the sectors that can't be handled by commercial banks. But given the past history of FIs, it will be interesting to observe the interest that may be shown by the players. Integrating this concept with the objective of developing the bond market will be possible, and should be pursued. Ultimately, any player who chooses to enter the fray would work around the financial viability of such projects before making an application. The pitfalls in the earlier dispensation of DFIs need to be addressed in detail by the applicants to reassure the central bank that these models can work.

Statistical significance is overrated

The idea of statistical significance has caused some problems in the way people read about and understand scientific findings

NOAH SMITH
Bloomberg

RONALD A FISHER, one of the fathers of modern statistics, reportedly got on the nerves of many of his contemporaries. But if there's a reason we should be annoyed with Fisher today, it's for coining the misleading term "statistical significance". Those two words don't necessarily mean that a finding is important or that an effect is big. It only means that the effect is clearly visible. It basically indicates how confident you can be that a result isn't due to random noise. As a measure of that, statistical significance already has some major problems. In 2016, the American Statistical Association issued a statement cautioning against excessive reliance on p-values, a common measure of statistical significance. Researchers such as Andrew Gelman, John Ioannidis and many others have demonstrated how these measures can be misused and misinterpreted to make accidental results seem real.

But beyond these methodological problems, the idea of statistical significance has caused some problems in the way people read about and understand scientific findings. First, statistical significance doesn't tell you how strong an effect is. For example, some studies find that low-skilled immigration drives down the wages of American workers without college degrees. This finding is statistically significant, but that doesn't tell you how big the effect is. Look closer and you notice that most of the papers find a very small impact—an inflow of 12 million low-skilled workers is predicted to reduce the wages of US high-school dropouts by a few percentage points at most. That's an effect worth considering, of course, but it's not as big a deal as most immigration opponents would have us believe.

How could such a small effect be statistically significant? The answer is: lots and lots of data. When researchers gather huge amounts of information, even tiny effects can be detected. In the age of big data, it's becoming easier and easier to find statistically significant needles in haystacks.

Because Fisher appropriated the word "significance" to mean detectability, there's no commonly accepted term for the size of an effect. Economists sometimes call effect size "economic significance," and biologists sometimes call it "biological significance," but these terms are specific to their fields, and rarely get picked up by the press. As a result, many people reading about the latest research results in the news don't realize how minuscule some of those findings are.

A second problem happens when people confuse statistical significance with explanatory power. For example, take the question of why people voted for Donald Trump. Many explanations have been advanced—racial resentment, economic anxiety, hostile sexism, authoritarian attitudes and a feeling of voicelessness. Each of these reasons has adherents who believe it's the key to understanding Trumpism. Each comes armed with studies showing statistically significant correlations between their preferred factor and Trump support.

> The focus of economics researchers on statistical significance perhaps comes from pharmaceutical testing

But you don't often hear about how much of Trump's support is explained by each. In statistics, there are measures of how well a model can explain the observed data—the most famous of these is called R-squared, which measure the percent of the variation in the data explained by a researcher's model. If you have an R-squared of one, your model explains everything. But if R-squared is close to zero, most of the reasons for whatever you're studying remain a mystery.

I've never seen a model that manages to get close to explaining all of Trump's support with factors like these. The closest I've seen is a study claiming that racist and sexist attitudes explained two-thirds of the gap between college-educated and non-college-educated white voters. Even this claim, if it turns out to be true (the highest R-squared I could find in one of their tables was 0.5), would leave a significant fraction of the gap unexplained.

So, people who look at these studies and say that "Trump voters are authoritarians" or "Trump voters are racist" need to realise that there are many different factors associated with Trump support, some of which nobody even knows. Just because these factors are statistically significant doesn't mean they're the whole story.

Many people who do statistical research in fields like economics are taught to ignore R-squared and other measures of explanatory power, and focus more on statistical significance. My hunch is that this attitude comes from pharmaceutical testing—if you're looking for a drug that reliably reduces headaches, you're mostly interested in verifying that it works so that you can start selling it to customers. That means you want to focus on statistical significance. But when trying to explain big social phenomena, the question of whether we know the whole story or only a small piece of it is often of central importance.

So, when you read about research findings, remember that statistical significance is only part of what you need to know. How strong an effect is, and how important it is in the real world, might matter even more.

LETTERS TO THE EDITOR

Delhi hospitals need more staffing

Ever since the Delhi government made all facilities, including tests completely free-of-cost in hospitals of Delhi, the waiting period for many tests like full-body-scan, MRI, etc, has been gone beyond one full year. One can see unending queues for even blood-tests, where sample-collection closes at 11.30 am. The rush of patients has increased manifold because patients are coming from neighbouring states to avail the facility. The Delhi government should utilise available costly infrastructure of hospitals in a better way by providing all the facilities including blood-tests, radiology-examinations and even out-patient-departments OPD round-the-clock by appointing more doctors and paramedical staff to work separately in three shifts to make hospitals run round-the-clock. All laboratories should also function round-the-clock. People who can't afford to come during the normal working-hours can then avail of the medical-facilities at night.

— Madhu Agrawal, Delhi

24X7 courts?

Apropos of the column by Bibek Debroy, "Let's look at getting a 365-day court" (*FE*, April 13), it is quite obvious globally private and public sector functions arebeing made available 24X7. So, why shouldn't Indian courts work for at least the normal working hours 365 days a year? The question is valid as it doesn't make any sense to shut down the whole machinery for months in keeping with a colonial custom to avoid the discomfort of working in the hot summers. The demand and expectations from courts has changed. It would be best for India to have round-the-clock courts to clear off the mounting number of cases and bring respite to the parties.

— Vinay Singhal, Gurugram

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ILLUSTRATION: SHYAM

FOODCAFE: BANKBAZAAR

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Banking on ease

Founders of Bankbazaar.com, Adhil Shetty, Arjun Shetty and Rati Shetty tell Sushila Ravindranath, about their paperless journey to financial industry

THE FOUNDERS OF BankBazaar, Adhil Shetty, Arjun Shetty and Rati Shetty suggest we have lunch at Krishna Villasam, an upmarket vegetarian restaurant next door to their office in Chennai. They assure me that they love the food served there, and are not making any concessions for my vegetarian tastes. The restaurant specialises in Reddiar cuisine from Tirunelveli, Tamil Nadu, with a strong influence of Kerala. We meet around 12:30 as the place gets very crowded after 1 PM and we cannot hear each other.

BankBazaar was launched almost ten years ago by three young people who grew up in Chennai, went to the US to study and work, but who always knew they wanted to come back. Adhil and Arjun are brothers and engineers, and Rati who is married to Arjun worked for Kraft both in the US and Taiwan. The company they set up is today India's largest online market place for a large number of financial products. It has attracted investors like Walden International, Fidelity Growth Partners, Mousse Partners, Sequoia Capital and Amazon among its backers, with a $60 million Series C round in 2015 being the most recent investment.

After we are shown to our table, Adhil demonstrates on his smart phone, how the website helps a customer who wants to invest in mutual fund make the choice from various options in a matter of minutes. "Do you know how much paper work you have to go through if you do it through conventional ways," he asks.

We get ourselves banana flower vadas and Arjun tells me that when he and Rati on a trip back home were trying to invest in a flat they found the experience harrowing. "We had to go from bank to bank, look for guarantors, and everything was so complicated. Things were really backward and fuzzy then. I knew that future was in enabling the customer to have an instant experience. Rati and I were convinced that there will be a paperless future. We talked Adhil into coming back as well to set up BankBazaar."

As it happened Adhil returned to India ahead of Arjun and Rati and started talking to people. "Initially there was a lot of scepticism. Family and some friends believed in us and we raised our initial funding of ₹45 lakh. I started building up a strong team. Our CTO had worked with Microsoft for ten years, and he had no hesitation in joining us. Hiring good people is the most important thing in this business. Our people are our biggest expense. The conversation that I have with our potential employees is on par with what I have with our investors."

We decide not to order thalis but ask for couple of *masala dosas* and vegetable *oothappams* which are served with flavoursome *sambar*, varieties of *chutnies*. What is special about the menu are the coconut and garlic *podies* (powders) which come with these dishes. Rati insists we also add on *rava dosas*.

BankBazaar was launched in 2008 with a six member team with an office in Chennai and two partner banks. "Learning from our personal experience we started identifying the needs of loan seekers and finding the right online solutions to help them find the best offers. I look at product experience from desktops, tablets, mobiles and different apps. We constantly work on how fast we can deliver with less friction. Finance is so complicated although it is part of our daily life. We continue to remain transparent, neutral and 100% compliant," says Rati. "Security is a major issue and we are constantly audited by multiple sources," adds Arjun.

> **Our mission has been constant. We said paperless in 2008 and we are saying it now. More devices and external developments have made growth possible**

All this is important as people continue to have a mind block about a process where the human element is not involved," says Arjun. Arjun who has a Masters from Georgia Tech had worked on the Amazon.com Visa Card programme. He had developed an online account acquisition strategy that made the program into one of the world's largest co-branded credit card programs. "We were building the foundation, relationships, and signing on partners in those early days of BankBazaar. It was not easy," says Arjun.

Since then BankBazaar has come a long way. It employs 1,050 people and has five offices. Chennai is the headquarters and there are offices in Bengaluru, Mumbai, Delhi, and Singapore. Adhil, the CEO who looks after business development and administration works out of Mumbai. Adhil got his masters from Columbia university, lived in New York City and managed Deloitte Touche Tomahatsu's US East alliances with the world's leading Information Management Company before he returned to India. The first international office was set up in Singapore last year.

As we are deciding on desert the founders tell me that they are big fans of Aadhaar. "So much waste has been eliminated because of Aadhaar. Aadhaar eKYC is a paperless Know Your Customer (KYC) process, wherein the identity and address of the customer are verified electronically through Aadhaar Authentication. It can be used as an alternative to the current KYC process which is done on the basis of physical photocopies of the original documents (ID proof and Address proof). "It is really a path breaker," they say.

"With paperless economy being the flavour of the season and the introduction of Aadhaar eKYC, isn't BankBazaar in the right place at the right time?" I ask. "Our mission has been constant. We said paperless in 2008 and we are saying it now." says Arjun. He says that more devices in the market and external developments slowly made their growth possible.

We decide to check out *ada pradhaman*, a Kerala sweet. I want to know when they will break even. "We already have positive unit economics. Now we are seeing month on month of positive EBITA. and by 2018 we will be profitable," says Adhil. "We have never sold anything at a loss. You cannot physically see the assets such as the credit rule engine we have built up. When you build a product there are high upfront costs. As we scale up, we are covering our fixed costs as well, explains Arjun.

As we are rushing through our filter coffee I ask them how they have managed to division up responsibilities. Is it working?" As it turned out our skills are broadly complementary. Adhil, the CEO, looks after sales and business development, Arjun takes care of platforms and systems and I products and customers. We went after our strengths, smiles, Rati.

All this backed by funding from Amazon, Sequoia, Walden, Fidelity and Mousse Partners. Personal finance marketplace BankBazaar, which is backed by Amazon, has launched new features on its Android app to help users view a real-time snapshot of their aggregated balance across multiple savings accounts and transaction history of individual bank accounts. Most people use more than one bank account, which makes it difficult to keep track of transactions and balances. BankBazaar.com solves this problem by displaying consolidated information in one single simple interface.

The reflation story is broadening

STEVE BRICE

The author is chief investment strategist, Standard Chartered Private Bank

Despite Trump not being able to push reform, there is more to the growth story

IT HAS BEEN MORE than five months since president Trump's surprise election victory infused new life into the eight-year long US equity bull market. Global markets have behaved as many, nticipated. The Trump administration's recent failure to push through a proposed healthcare bill through the US Congress can thus be seen as the first speed bump. Investors are now questioning president Trump's ability to make progress on the critical aspects.

Given this, is it time for investors to hit the pause button? Or, is there more to the reflation story?

We believe a US tax deal will be reached, but that this will take time, especially since the Republicans will be keen to ensure that there are, optically at least, revenue-boosting elements to any stimulus package that make any tax cuts budget-neutral over the longer run.

As it turns out, the reflation theme seems to be broadening beyond the US shores, with economic and corporate earnings growth estimates generally being revised higher, especially in Europe and Asia. Interestingly, the fiscal policy debate in Germany, which until now had led the Euro area's move towards greater austerity, also seems to be shifting back in favour of more easing. We are also seeing signs of a revival in Asian imports and exports, while Russia and Brazil are emerging from a couple of years of recession. China's policy-induced stability has clearly helped in this regard.

This bodes well for the medium term (6-12 month) outlook for equity markets. Thus, global equities remain our preferred asset class. Earnings growth expectations are robust and the pivot from economic 'muddle-through' to 'reflation' suggests this is unlikely to change dramatically. However, a gradual shift away from extremely loose monetary policy settings and, in some regions, elevated valuations suggest future equity market gains will be driven by earnings growth as opposed to price-to-earnings multiple-expansion, which is normal feature at this stage of a cycle.

> **Developed market treasury yields are likely to move higher as the reflation story unfolds and the Fed gradually removes accommodation**

Valuations in the Euro area are relatively low compared to the US, while 2017 earnings growth expectations have risen.

Economic data is improving and the US dollar's stability should be a positive as it means domestic policy settings can remain loose and Asia ex-Japan could benefit from a pick-up in FPIs. Within Asia, India and China remain our preferred markets.

Within bonds, there is a clear a preference for corporate bonds over government bonds and, particularly, for areas of the market that have less sensitivity to rising interest rates. This is because developed market government bond yields are likely to move gradually higher as the reflation story unfolds and the Fed gradually removes accommodation. Meanwhile, companies' ability to service their debt is likely to improve under this environment.

Thus, our two preferred areas are US floating rate senior loans and developed market high yield bonds. Both sub-asset classes have significant credit risk but, because of this, offer higher yields and lower sensitivity to rising yields.

We are a little more cautious on Asian bonds though. Issuers from China and Hong Kong have become increasingly dominant players in the Asian dollar bond market. This exposes investors to higher concentration risks. Although China's tightening capital controls and gradually rising interest rates have been successful in stemming outflows, any increase in concerns about China or reduced flows from Chinese investors could lead to sharp pullbacks in the market.

Of course, there are always risks of short-term weakness in equities and other riskier assets, especially at this time of the year, given seasonal tendencies and the upcoming elections in France. While we do not expect Eurosceptic parties assuming power and undermining the global, or even regional, economic outlook.

Also, some market indicators, such as implied volatility across different asset classes, do hint at investor complacency. However, fund manager surveys show there is still significant cash sitting on the sidelines which has yet to be deployed into markets. This is usually an indication of further equity market upside.

COMPANIES BILL

Fraud of the flies

By catering to the twin objectives of deterrence, and promotion of ease of business, the 2016 Companies Bill, 2016 has attempted to break new grounds in legal jurisprudence

SHOHINI SENGUPTA

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DHE COMPANIES (Amendment) Bill, 2016 was one of the major legislations introduced in the country in the past year, introducing several amendments to the Companies Act, 2013 (Act), to fortify corporate governance, simplify procedures, and make the statute more amenable to compliance. One of the major proposals in the Bill was an amendment to section 447, on 'punishment for fraud', by putting monetary thresholds, and restricting the scope of the term 'fraud' to offences involving an amount of at least ₹10 lakh, or 1% of the turnover of the company, whichever is lower; and creating a distinction between frauds that involve public interest, and those that do not.

The genesis of this provision dates back to the year 2009, which started on a dangerously bad note. One of India's biggest corporate frauds in Satyam Computer Services Ltd was unearthed, and the Companies Act, 1956 was analysed afresh, with a view to charting a better future. The Standing Committee in its 21st Report (2009-10) expressed serious concern over the lack of a definition of 'fraud' in the then statute, and the lack of mechanisms to efficaciously deal with such cases.

This was followed by the Standing Committee's 57th Report (2011-12) which recommended a number of strategies to counter fraud and accord a statutory status to the Serious Fraud Investigation Office (SFIO), along with prescribing due safeguards to it (section 212). Accordingly, the Act, as we now know it, included several aspects of these recommendations to strengthen the corporate law regime in the country.

However, in 2016, the Report of the Companies Law Committee found that there were a number of concerns in respect of the punishments accorded to different provisions. It would be worthwhile to note that one of the larger recommendations of the Committee was to draw attention to the regime of penalties, and to make it "commensurate to the gravity of the crime". Thus, an attempt was made in the Amendment Bill to segregate the offences into procedural, and other offences.

The inherent philosophy behind section 447 was the assumption that all frauds were of equal measure, and in any case, must be dealt with seriously, and hence liable to be penalised in the same manner. While it was understood that in the context of what had transpired in 2009, the penalty provision in section 447 of the Companies Act, 2013 was deliberately kept very stringent, with imprisonment for a term not less than six months, extending up to 10 years, along with fine not less than the amount involved in the fraud, extending up to three times the amount involved in the fraud. The concepts of "wrongful gain" and "wrongful loss" itself being inconsequential to the commission of the fraud, the recommendation of the Committee was to introduce a monetary threshold to the provision. This was perhaps also an homage to the JJ Irani Committee, which in its report in 2004 noted that the Companies Act ought to provide flexibility for the levying of penalties, which could include factors such as the "the size of company, nature of business, injury to public interest, nature and gravity of default, repetition of default, etc." This also flows from the general principle of criminal law, which already allows for various courts and tribunals to exercise due discretion in the adjudging penalty, depending on various factors.

The Standing Committee's 37th Report of 2016-17 on the Bill has concurred, and added that the prescription of monetary thresholds to the provision adds more clarity both "to the nature of fraud and for categorising the offence as compoundable or non-compoundable."

The Kroll Annual Global Fraud Report, 2017, released earlier this year presented a chilling reality, when it stated that "fraud, cyber, and security incidents are now the new normal for companies across the world." It further noted that while corporate frauds in 2016 were reported to be 80% less than 2015, India continued to be on top of the list, reminding us once again of the debilitating impact of corporate frauds. The aim of the statute is not just to deter people from committing frauds, but also to encourage the recruitment of the best managerial personnel. As such, indiscriminate and severe penalties for even minor infractions could be a cause of concern, rather than act as deterrence; not allowing talented personnel from joining.

Further, it should also be noted that section 447 does not operate on a standalone basis, and is in fact, intrinsically linked to a host of other provisions. Severe punishments, without reasonable qualifications could not only cripple the operation of the statute, but also affect a number of related provisions. A number of legislations across the world, including the UK Companies Act, 2006, and the Singapore Companies Act, 2006 have enshrined the principle of differential treatment of companies and offences, based on globally accepted norms, to ensure a higher rate of compliance, and discriminate between minor infractions.

The concept of fraud has been encapsulated under other legislations as well, including the Indian Contract Act, 1872 and the Indian Penal Code, 1860. However, by allowing for a distinct definition of fraud in the Companies Act, 2013, and catering to the twin objectives of deterrence, and promotion of ease of business, the Bill has attempted to break new grounds in legal jurisprudence. As William Golding sounds a cautionary note in his famous book, 'Lord of the Flies', "Which is better—to have laws and agree, or to hunt and kill?"