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## THIS ISSUE



### Participatory Notes

Financial instruments used by investors or hedge funds that are not registered with the Securities and Exchange Board of India to invest in Indian securities. Indian-based brokerages buy India-based securities and then issue participatory notes to foreign investors.

### Volkar Rule

A federal regulation that prohibits banks from conducting certain investment activities with their own accounts, and limits their ownership of and relationship with hedge funds and private equity funds, also called covered funds. The Volcker Rule's purpose is to prevent banks from making certain types of speculative investments that contributed to the 2008 financial crisis.

### Keynesian Liquidity(Liquidity Trap)

A situation in which prevailing interest rates are low and savings rates are high, making monetary policy ineffective. In a liquidity trap, consumers choose to avoid bonds and keep their funds in savings because of the prevailing belief that interest rates will soon rise.

## Hawala: An Illegal or Legal Banking

Hawala is a dirty word. It smacks of black money, sleazy back alleys doing surreptitious transactions in small notes, and dodgy businessmen with fictitious balance sheets. And yet, at the heart of it, hawala is not too different from normal banking.

The big question before anyone in international business is how to receive or send value for the goods and services you have sent or received across countries. How do you convert your assets (rupees) held in India into dollars abroad or vice versa, like NRIs sending money home. Business and people use the banking system to settles these dues. But when regulations bar settlements, they shift underground . Hawala is simply the settlement process designed to circumvent regulation.

At the bottom of hawala is compelling business logic. When India banned gold imports and it had to be smuggled to meet local demand, businessmen had a problem. They sold the gold here in rupees and had to pay for it in dollars in Dubai. Their dollar liability had to be offset against rupee assets. Since they couldn't use banks, businessmen had to find another way of getting the dollars. Workers from Kerala remitting money home were the perfect opportunity.

By offering more than the official exchange rate, businessmen bought dollars off these workers to pay for the gold. An equivalent amount of rupees was delivered to their families in Kerala . Though the situations may vary, this perfect scheme can be bolted on anything of value. Underground trade financing or hawala begins when a law obstructs natural trade or artificially raises the value of goods and services.

Take, for instance, the current minimum export price (MEP) fixed by the government for basmati. Government believes basmati is worth $900 per tonne, while its actual market value is $700 per tonne. If the Indian exporter follows the MEP, he will receive more dollars than his rice is worth, which, needless to say, has to be returned to the foreign buyer.

Since the deal can't be transacted at current market price because government says no, the Indian exporter will either mislabel his basmati as non-basmati because it doesn't have an MEP or use hawala. Metal exporters are equally pressured to indulge in over-invoicing .

Hawala needs an opposite trade flow not bound by regulation to complete the cycle. Before it got access to bank loans, Bollywood was routinely financed by moneybags in Dubai. To pay back, the producers would sell the film's overseas rights to these financiers for a song. Politics is another breeding ground for convoluted settlement routes .
For example, led by US, the world is refusing to let Iran trade in dollars. India exports a bulk of its basmati to Iran. The Iranian buyer is not allowed to pay the Indian exporter in dollars while the Indian exporter has no use for the Iranian rial. So, the buyer deposits an equivalent amount of rial with his local bank. The bank uses a country that trades with both Iran and India for settlement. The current favourite is Japan, which imports oil from Iran and also trades with India.

### FrontRunning

The unethical practice of a broker trading an equity based on information from the analyst department before his or her clients have been given the information

### Tailgating

When a broker or advisor buys or sells a security for a client(s) and then immediately makes the same transaction in his or her own account.

### Sterilization

A form of monetary action in which a central bank seeks to limit the effect of inflows and outflows of capital on the money supply. Sterilization most frequently involves the purchase or sale of financial assets by a central bank, and is designed to offset the effect of foreign exchange intervention. The sterilization process is used to manipulate the value of one domestic currency relative to another, and is initiated in the foreign exchange market.

The bank in Japan agrees to use some of the money it owes Iran to settle Iran's dues with India. That is why most Indian rice exporters are flush with the yen. Of course, hawala is not inevitable . A market that is neither illegal nor criminal can emerge for working around currency controls. For instance, the rupee is not fully convertible.

This makes it impossible for foreign companies and investors to hedge their rupee-dollar currency risk. But leading international banks in Singapore, London , Dubai and Hong Kong offer non-deliverable forward contracts in the rupee, designed to get around RBI controls. In this market, no exchange takes place of the two currencies' principal sums. The only cash flow is the movement of the difference between the contract rate and the rupee's prevailing spot market rate.

This amount is settled in dollars on the settlement date. Not a single rupee leaves India. Being offshore, the market is outside RBI control. Hawala has been blamed for inflated export data. But its very presence indicates illogical regulation fettering legitimate transactions. Once these transactions are driven underground, they require protection provided by criminals seeking a slice of the action.

Luckily, this also means hawala can be wiped out by removing any laws out of sync with current market reality, such as liberalising gold imports. Ultimately, hawala is a matter of perception. All underground trade financing deals are legitimate business transactions banished by a rule somewhere that says they

## Round tripping of funds: Present Scenario

**What it is all about?**

An action that attempts to inflate transaction volumes through the continuous and frequent purchase and sale of a particular security, commodity or asset. Round-trip trading can be used to refer to the practice of a business selling an unused asset to another company while agreeing to buy back the same asset for about the same price. This type of market manipulation has been seen in the energy and telecom business.

**SEBI Taking Action on Roundtripping**

SEBI is looking into the possible use of Protected Cell Companies (PCCs) from places such as Mauritius, Cayman Islands and Seychelles for use of round-tripping of Indians' money back into the capital market here in the form of overseas funds.In 2010, Sebi had barred PCCs to invest in Indian markets through FII (Foreign Institutional Investor) route after it came across instances where certain Indians had used these entities to route their money back into markets as FII funds.

**Present Condition:**

Funds structured as PCCs, which are legal entities in places like Mauritius, might be looking at a re-entry into Indian markets through routes like Foreign Venture Capital Funds and other avenues for the purpose of round-tripping of funds.