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THE AMERICAN BANKING SYSTEM

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...Page (1)

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...Page (4)

G20 2023 SUMMIT

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...Page (7)

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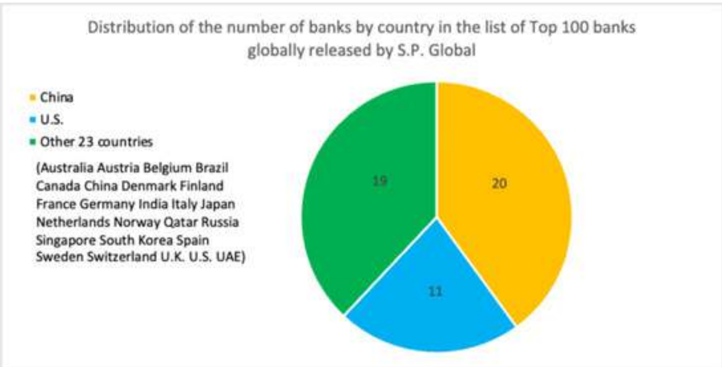
The American financial system has long been recognized as a stronghold of durability and economic strength in the ever-changing world of global finance. These financial giants have, for years, been instrumental in shaping the global financial landscape, their influence and growth extending far beyond national boundaries. S&P Global's annual ranking of the world's top 100 banks offers a vivid testament to this dominance, with American Banks claiming a remarkable 11 spots. The only other country with more banks on the list is China, having 20.



However, as of 2023, a shifting paradigm has emerged, casting a discerning spotlight on the American banking system. The American economy now grapples with unprecedented challenges from converging local economic policies and political decisions. Rather than diminishing their significance, these strains have raised critical questions about the resilience of the country's banking system and laid bare its comparative strengths and vulnerabilities.

REASONS BEHIND THIS CRISIS

The year 2023 bore witness to three of the most significant banking failures in American history. According to The New York Times, these failures, attributed to Silicon Valley Bank, First Republic Bank, and Signature Bank, collectively accounted for a staggering total asset value of $532 billion. This figure surpasses the inflation-adjusted sum of $526 billion held by the 25 banks that succumbed during the historic 2008 financial crisis. While a substantial portion of the blame rests with individual banks due to their ill-advised decisions and unchecked expansion, we cannot overlook the role played by macroeconomic policies and events.

Unrealised Interest rate losses and Uninsured Deposits

The United States Federal Reserve embarked on an extensive loosening of monetary policy during the COVID-19 pandemic, employing quantitative easing and lowering interest rates to a range of 0 to 0.25%. Quantitative easing involved the Federal Reserve purchasing billions of dollars in bonds to stimulate economic growth and stabilize financial markets. Concurrently, banks received loans from the Federal Reserve to support local businesses and households grappling with the pandemic's aftermath.

Banks witnessed significant capital inflows despite historically low-interest rates due to the "flight to safety" phenomenon. Often observed during crises, this phenomenon reflects a market preference for secure investments like gold, bonds, and bank deposits over riskier assets like equities. Government stimulus programs ensured businesses and households had access to disposable income, which they subsequently deposited into banks.

This led to an unprecedented surge in bank deposits. Official data from the Federal Reserve reveals that domestic commercial banks' total deposit value surged by approximately 35% from the close of 2019 to the fourth quarter of 2021, marking the most substantial increase in American history. Paradoxically, despite all measures, demand for loans remained low.
Consequently, the excess deposits held by banks found their way into U.S. treasury bonds, creating an interest rate risk. Banks were now in possession of long-term treasury bonds as assets and short-term deposits as liabilities.

When the Federal Reserve commenced a series of interest rate hikes between March 2022 and July 2023, totalling 11 increments, it marked the highest rate of increase in 22 years (Source: J.P. Morgan). The fundamental principle of economics dictates an inverse correlation between interest rates and bond prices. As interest rates rose, bond prices plummeted, resulting in substantial paper losses for regional banks across America. In their paper, "Why do banks invest in MBS," Professors Phillip Schnabl, Itamar Drechsler, and Alexi Savov, affiliated with the New York University Stern School of Business and the Centre for Economic Policy Research, calculated a colossal $1.7 trillion in total unrealized losses on bank credit by December 2022. This amount, when contrasted with the total bank equity capital of $2.1 trillion in 2022, underscores the magnitude of the issue.

The United States also maintains a deposit insurance system where the government guarantees account safety in insured banks, covering sums up to $250,000. Anything above that amount is uninsured. According to the Federal Deposit Insurance Corporation data, the insured deposits constituted $10.1 trillion out of the total of $17.7 trillion deposits held by the banks. Uninsured deposits pose a significant risk, as even a modest withdrawal could compel a bank to prematurely liquidate long-term investments at substantial losses, effectively pushing the institution toward bankruptcy.

Removal of regulations

In 2018, the Republican government amended the Dodd-Frank Wall Street Reform and Consumer Protection Act, introduced after the 2008 financial crisis. These amendments raised the threshold for banks subject to enhanced regulatory standards from $50 billion to $250 billion.

Consequently, fewer banks were subject to regulatory requirements such as stress tests, which assess banks' resilience in adverse economic scenarios, evaluating their capacity to maintain capital adequacy and financial stability. Had these amendments not been introduced, the systemic issues could have been detected and addressed sooner.

THE CURRENT STATE

A range of measures were implemented by The Federal Reserve to address the challenges confronting banks, and while these initiatives achieved some success, issues and vulnerabilities remain. Regional banks in the United States continue to grapple with potential hurdles stemming from the ascent of interest rates, elevated funding expenses, and a gradual shift of funds toward larger banking institutions. Moreover, the 2023 banking crisis in the United States has underscored the heightened risk of bank runs, primarily attributable to the pervasive influence of digital media and the rapid dissemination of panic within the financial markets.

-Hriday Amonkar

MIGRATION TO ONE HOUR AND EVENTUALLY INSTANTANEOUS TRADE SETTLEMENTS?

A trade settlement is a two-way process which involves the transfer of funds and securities on the settlement date. A trade settlement is said to be complete once purchased securities of a listed company are delivered to the buyer and the seller gets the money.

The current cycle of T+1 means trade-related settlements happen within a day, or 24 hours of the actual transactions. The migration to the T+1 cycle came into effect in January this year. India became the second country in the world to start the T+1 settlement cycle in top-listed securities after China, bringing in operational efficiency, faster fund remittances, share delivery, and ease for stock market participants. We are now talking about a one-hour settlement and that will serve as a stepping-stone to instantaneous settlement.

If you're wondering why do shares currently take 1 day to settle? Well it isn't as simple as it seems. The settlement process involves various backend operations such as clearing and payment systems, which require time for verification and processing. The 1-day settlement period allows for the smooth transfer of securities from the seller to the buyer and ensures that funds are properly settled.

SEBI, the Securities and Exchange Board of India, is planning to revolutionise the trade settlement process with its proposed 1-hour trade settlement mechanism; this will be followed by instantaneous settlement. With this, entities can receive funds and securities simultaneously, this move would revolutionise global markets and potentially set new standards.

Amid concerns raised by certain foreign portfolio investors on the shortening of the settlement cycles citing forex-related worries and information flow system, the SEBI officials made it clear that faster settlements are optional and investors can opt out. It was further disclosed that the road map is from one hour to instantaneous as the former is quicker to implement, the technology for one hour settlements already exists and SEBI is confident about the same.

According to the SEBI Chairperson, one of the reasons we are moving towards quicker settlements is the fact that incumbents have been morphing into fintechs, this calls for better technology. Faster trade settlement is the need of the hour as speed and efficiency are epoch making in today’s fast-paced world.

Do we think one hour settlements are possible?
If we were to look on the surface, India is the only second country to bring about a t+1 settlement. But, as per the SEBI chief t+0 or instant trade settlement is possible because of the availability of real-time payment systems such as Unified Payments Interface (UPI), online depositories and other technology stack.

What should we look forward to?

- Remarkable change for intra day traders in the form of mitigated risk as they will have to rely on leverage relatively less(Intraday leverage refers to the additional capital provided by broking companies or stock brokers to day traders in the NSE market, allowing you to trade in larger volumes than your own capital would permit.)

- Faster trade settlements would mean transactions are completed quickly after execution and this would reduce the opportunity for manipulating the stock market. Price manipulation includes activities that distort security prices for personal gain.
- Efficient price discovery is the market's ability to determine fair prices based on supply and demand. Faster settlements contribute to more accurate price discovery by minimizing manipulation. Ultimately, this leads to fairer and more reliable valuations of securities in the market.
- Instant access to funds: Investors can access their funds immediately after selling their shares. This will reduce the overall capital requirement, increase the trading volume and essentially, it will streamline the process of continuously reinvesting in the market, facilitating more fluid and dynamic trading strategies. To sum it up, the investors will have the opportunity to reinvest their capital into different assets or securities.

All in all, a large number of investors and traders will be attracted to the market, thereby making it more competitive.

Should we look out for clouds on the horizon?

- Market volatility will amplify as traders will be able to move in and out of positions, this could lead to destabilising prices. This could potentially mean the market would become , less predictable and subject to sudden swings, which would further mean that the investors' decisions may not be as well informed as before.
- With the increased convenience, we will have to face the downside of cybersecurity concerns and possible settlement failures. Faster settlement may lead to difficulties in reconciling trades and ensuring that all details match correctly between the buyer and seller. Any discrepancies related to the same could lead to delays, disputes or even financial losses. Therefore, less time for due diligence is likely to increase the likelihood of oversight and errors.
- Earlier this year when SEBI implemented t+1 settlements, it posed difficulties for foreign investors; one hour settlements are only going to exacerbate the problem. Apart from time zone differences and foreign currency fluctuations, the technology structure and pre-funding accounts will come into play.
- As the co-founder of Zerodha, Nitin Kamath, has already mentioned Intraday traders encounter several challenges with instant settlement. Their trading style, which involves rapid buying and selling without intending to take or give delivery of stocks, may not align well with the immediate settlement requirement. Instant settlement demands quick delivery and payment, limiting intraday traders' flexibility to exit positions swiftly and efficiently. The heightened market volatility resulting from immediate settlement can complicate precise market timing, leading to suboptimal decisions.

In our humble opinion, as India moves towards instant settlements, it sets a new benchmark for global capital markets. It is rightfully said that with opportunity comes challenges, however we believe that the favourable changes that t+0 settlements could bring about would far outweigh the potential risks; it is safe to say that the advantages will be a probability, however the risks will be a possibility.

-Sanjana Bajaj

G20 2023 SUMMIT

SHAPING A GLOBAL FAMILY AND RESHAPING THE WORLD IN NEW DELHI, INDIA

In the heart of New Delhi, India, the G20 2023 Summit convened amidst a world grappling with unprecedented challenges. Against the backdrop of the ongoing Russia-Ukraine war, the summit reaffirmed the age-old Indian philosophy of "Vasudhaiva Kutumbakam," which translates to "the world is one family." This profound idea encapsulates the spirit of unity and collaboration that prevailed during this critical gathering of global leaders.

African Union Inclusion: Strengthening Bonds

One of the paramount outcomes of the G20 2023 Summit was the inclusion of the African Union as an invited guest. This historic decision underscored the growing significance of the African continent in global affairs and demonstrated the G20's commitment to fostering a more inclusive and equitable world order. The inclusion of the African Union was a clear recognition of Africa's contributions and potential in addressing shared global challenges, from climate change to economic development.

IMEC MOU: A Step Towards Economic Stability

A significant milestone at the summit was the signing of a Memorandum of Understanding (MOU) on the International Monetary and Economic Council (IMEC). This MOU aims to create a global platform for economic coordination and crisis management, enabling nations to more effectively to financial challenges. In a world marked by economic uncertainties, the IMEC MOU emphasizes the importance of international cooperation in maintaining economic stability and promoting sustainable growth.

Financial Inclusion Initiatives: A Digital Revolution

During the summit, discussions on financial inclusion took center stage. The G20 Global Partnership for Financial Inclusion Document, prepared by the World Bank, celebrated the transformative impact of India's Digital Public Infrastructure (DPI) under the Central Government over the past decade. Key initiatives highlighted in the document include:

1. Rapid Financial Inclusion:
India's DPI approach achieved an astounding feat, condensing 47 years' worth of financial inclusion progress into just six years. The Jan Dhan-Aadhar-Mobile (JAM) Trinity played a pivotal role, boosting the financial inclusion rate from 25% in 2008 to over 80% within this short span. Regulatory frameworks, national policies, and Aadhaar-based verification complemented DPIs, ensuring that financial services reached even the remotest corners of India.

2. Pradhan Mantri Jan Dhan Yojna (PMJDY) Success:
The PMJDY program witnessed remarkable growth, with accounts tripling from 147.2 million

in March 2015 to an impressive 462 million by June 2022. Of particular note is that women own 56% of these accounts, exceeding 260 million. PMJDY not only expanded access to financial services but also ignited a culture of savings among low-income women, attracting over 12 million new customers by April 2023.

3. Government to Person (G2P) Payments Revolution:
India's digital G2P architecture facilitated USD 361 billion in transfers to beneficiaries from 53 ministries via 312 schemes. This system achieved total savings of USD 33 billion by March 2022, equivalent to 1.14% of the nation's GDP, highlighting the efficiency and transparency achieved.

4. Unified Payments Interface (UPI) Dominance:
UPI transactions reached unprecedented heights, with over 9.41 billion transactions valued at Rs 14.89 trillion in May 2023. UPI transactions in FY 2022–23 nearly reached 50% of India's nominal GDP, showcasing the convenience and accessibility it has brought to financial transactions.

KEY HIGHLIGHTS OF G20 2023

The G20 2023 Summit witnessed several key highlights:

1. Climate Action:
G20 leaders reiterated their commitment to combat climate change, with a focus on sustainable and green technologies, aiming to achieve carbon neutrality.

2. Pandemic Response:
The summit addressed ongoing efforts to combat the COVID-19 pandemic, including vaccine distribution and preparedness for future health crises.

3. Trade and Investment:
Leaders discussed ways to promote free and fair trade and reduce barriers.

4. Finance Track Agreements:
India's G-20 presidency has laid the foundation for a coordinated and comprehensive policy and regulatory framework for cryptocurrencies.The emergence of global consensus on crypto asset regulation was emphasized.G-20 leaders have recognized the pressing need to foster economic growth through international cooperation.

5.India’s Cultural Showcase:
Bharat Mandapam (inspired from Anubhav Mandapam).Bronze statue of Lord Nataraja (Chola style).Konark Chakra of Odisha’s Sun Temple and Image of Nalanda University (used as iconic backdrops).Thanjavur Paintings and Dhokra art. Brass statue of Lord Buddha sitting under Bodhi tree.Diverse musical heritage (Hindustani, Folk, Carnatic, Devotional).

6.Transition of G20 Presidency:
Prime Minister of India handed over the customary gavel of the G20 chair to Brazilian President Luiz Inacio Lula da Silva, who will officially take over the presidency on December 1, 2023.

India-US Collaboration

Notably, India and the United States announced collaboration on multiple fronts. This includes efforts to remove Chinese telecom equipment from their networks, citing national security concerns. Additionally, India is actively assisting the US in defense manufacturing, further strengthening bilateral ties.

In conclusion, the G20 2023 Summit in New Delhi exemplified the power of international collaboration in addressing pressing global challenges. Rooted in the timeless philosophy of "Vasudhaiva Kutumbakam," the summit emphasized unity and cooperation in a world marked by complexity and uncertainty. With landmark agreements, financial inclusion initiatives, and key highlights, this summit charted a course towards a more stable, equitable, and sustainable global future.

-Archismita Pattanayak

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G20 2023 Summit

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