International Summit
Banking, Insurance and Financial Services for Infrastructure and Economic Development in Punjab
with Domestic Corporate, NRI/Foreign Direct Investors/Venture Capitalists
Saturday, the 24th June 2006, Chandigarh, India

Backgrounder
# Agenda 2006

**Global Competitiveness - Anchoring NRI Investment & FDI in Punjab**

**Business Networking with Indian Corporate**

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**Will lead to**

Investment-Infrastructure Development-Employment
Released

at

International Summit
Banking, Insurance and Financial Services
for
Infrastructure and Economic Development in Punjab

on

Saturday, the 24th June 2006
at Hotel Mountview, Chandigarh, India
Introduction

According to Shakespeare 'out of this nettle, danger, we pluck this flower, safety'. The economic development model adopted by India in the post-independence era has been characterized by mixed economy with the public sector playing a dominating role and the activities in private industrial sector control measures emaciated from time to time. As financial service providers look to the future, they are struggling to sustain growth in a world of fast-changing threats and opportunities. The choices that financial institutions are making every day will determine whether they can achieve their goals of exploiting emerging opportunities, managing risks and gaining a competitive advantage during this crucial period.

Financial markets are a part of the changing business paradigms, across the globe. In fact, the financial markets are the first to unleash the creativity and imagination and lead the revolution. Today, globalization of competencies, thinking and perspectives has been the part of Strategic Action Plan of all the major players in the financial markets, globally. The cut throat competition across the market operators and the pressure to perform by the stakeholders has resulted in competition being fiercer than ever before. I think, both the business landscape and chemistry of the competition has changed significantly over the period of time. All around, there is a fresh thinking on the financial products, structure of market players and possibilities for value creation. I would say financial markets are being redefined, reinvented and reconfigured on a persistent basis.

Changing paradigms of the financial services

Today, financial markets are turbulent, globally. Traditional business models, when businesses were clearly differentiated (Banks conducted banking, insurance companies offered risk covers and securities companies offered investment opportunities), have become the footnotes of the finance literature. Today, insurance companies are exploring values in the banking and investment products and vice versa. It is no more a bank competing with another bank and insurance company competing with another insurance company, but an insurance company competing with banks and what not. Hence, to my mind, the most precious word today is the “convergence” of the opportunity zones in financial markets from concept to culmination. It may be observed that the competitive dynamics of market has changed phenomenally. Today, players in the market compete in one segment and co-operate in other segment. Strategic alliances of the competing banks on the ATM infrastructure is a live example of this. Today, Mutual Funds compete with the Banks on deposits, as they too provide the cheque facility with certain limitations. Revolutionary waves have gone to the extent of providing the ATM facility to the Mutual Funds investors. It is very interesting to observe the competition mounting across the opportunity zones because that encourages people to improve and deliver better values to the market leading to growth of overall productivity of the nation. Another example here is that of the insurance products. You would observe that the buyer of the insurance products also looks at them as the investment products. This is an issue of conditioning over the period of time and
therefore, the customers of the insurance products are both the customers of the risk protection and the investment products. That leads to the insurance sector competing with the other avenues of the investment including banks, financial institutions and investment companies. The structure of the players in different opportunity zones is also changing on a continuous basis. Corporate marriages, exchange’s mergers, clearing corporations alliances, regulator’s integration, globally, bear testimony to it. Convergence of the financial products is also apparent, everywhere. As an example, let us look at the securities brokers. They are no more securities brokers; they are the brokers exploring opportunities across different dimensions of the economy. Similarly, enterprises in the finance are talking about one stop shop offering all the products ranging from commodities to securities to currencies under one roof. This change in business models is necessitated by the values buried in the interlinkages of the opportunity zones, emerging from economies of scale and economies of scope. On exchanges side, more and more products are migrating to the exchanges for trading. Globally, availability of all sorts of financial products (both money market and capital market) on the exchanges is driven by the benefits like transparency, better price discovery,

**Engines of growth**

Financial services executives cite the same transformative issues – globalization, regulation, risk, demographics and technology – but rank them differently depending on their sector. Based on those issues and our client experiences, we have identified five strategic imperatives for financial services firms

**Embrace opportunities in new markets**

The most successful firms will continue to exploit the promise of fast-developing economies and easing cross-border investment regulations. Most large financial institutions are already there: in Central and Eastern Europe, and in Asia, where there are at least a half-dozen countries vying to become regional financial services hubs. Europe is poised for retail financial services consolidation on a scale seen in the US market in the 1990s. Many European institutions are looking at opportunities in other European countries. While not “new” markets in the traditional sense, they are strategically viewed as a way to gain entry into areas where institutions have not previously had a strong presence. Crossborder mergers, driven by the need to grow earnings, the appeal of economies of scale and a more encouraging regulatory climate, could lead to the disappearance of hundreds of banks and the emergence of a handful of pan-European players by 2010. Offshoring, which has become a competitive necessity over the past 10 years, will ramp up as firms recognize the improvement in quality they can realize through the well-qualified people and cost savings attainable by scaling up their operations, particularly in areas like India, the Philippines, Malaysia, China and other markets in Asia Pacific. Firms will continue to look beyond IT to actuarial services, human resources and other back-office functions. Increasingly, they will need to simplify
Refocus customer relationships through technology and innovation
As direct customer access and pricing pressures lead to commoditization, customer focus must become central to strategy. Financial institutions are increasingly focusing on delivering an innovative customer experience – one that is targeted to unique segments and emphasizes convenience, service and value. Technology has empowered customers to loosen ties with financial services providers, but it can also be harnessed to rebuild and strengthen relationships. On the retail side, the focus will be on personalization, ease of navigation and a revival of personal client contact as one component of a multi-pronged relationship. On the institutional side, capital markets firms will develop more sophisticated client platforms that provide trading scenario analysis, risk modeling and performance management reporting.

Adopt a principle-based approach to regulatory compliance
Across all sectors and countries there is deep concern about the cost of regulatory compliance. No financial institution is immune: From Basel II, Solvency II and Sarbanes-Oxley to a country-by-country laundry list of new laws and tougher enforcement of old ones, firms face an expensive and confusing regulatory landscape. Given the number and mandates of regulators, it is no longer possible to adopt a reactive, piecemeal approach to compliance. Instead, institutions are gaining a competitive advantage by introducing principle-based compliance into their governance and management culture and embedding it into the business, effectively training and deputizing every manager. At the same time, by taking a strategic, disciplined approach to their formal compliance function, firms can avoid costly overlap and duplication of effort. Across geographies and business lines, firms need to adopt a uniform methodology for documenting compliance risks and controls and testing and implementing those controls, using evolving technology to assist.

Address risk in the context of an enterprise risk management framework
Operational risk is top of mind for financial services firms. More than half of those surveyed identified operational risk as harder to manage and an area of greater concern than market, credit and liquidity risk, perhaps because they already have a solid handle on those risk types. Similarly, reputational risk, which is intertwined with operational, compliance and other risks, is emerging as a central concern. A strategic, holistic approach – through an enterprise risk management framework – can help mitigate risk across the board. Specific actions may range from vetting supply-chain organizations for
potential reputational issues to developing a consistent internal and external communications strategy. More firms are employing enterprise risk management (ERM), which can provide a value proposition for the board and senior management.

**Capture assets in the retirement market**

In the graying markets of the US, Europe and much of Asia, payouts will soon begin on trillions of dollars in retirement assets. At the same time, responsibility for retirement security is increasingly shifting to the individual and away from governments and employers. To date, financial providers have pursued affluent baby boomers and early retirees. Future growth will come from helping retirees maintain a steady stream of income. To achieve long-term success and differentiate themselves from the competition, now more than ever, financial institutions will have to foster relationships with individuals, provide advice and develop products that meet their needs at all stages of the life cycle. As defined contribution plans continue to supplant defined benefit plans, the plan sponsor increasingly will be viewed as the conduit to the individual client rather than the client itself.

**Crossing borders and creating opportunities**

Whether through M&A activity, offshoring or origination and distribution in new markets, financial services firms now have greater opportunity to cross borders than ever before. HSBC is aggressively growing its business in new markets – both developed and emerging. Over the next 25 years, it projects much of the world’s growth coming from Asia, where it is making big investments in banking and insurance, and the Americas, encouraged by the NAFTA agreement. BlackRock, which has $100 billion in international client assets out of a total $453 billion, is seeking to expand its global reach to keep up with the globalization of the capital markets and the growth of ideas. “We’re trying to be less US-centric, to stop exporting Americans overseas, to become more global in manufacturing, client service and technology,” says Laurence D. Fink, chairman and CEO. BlackRock sees opportunity in the Middle East, Asia and in the retirement business in Europe. Firms looking at new markets must decide whether to make an acquisition, collaborate in a joint venture with a local entity or (where permitted) start operations from scratch. Regardless of the chosen approach, the message is clear: embrace new markets, but only with a clear understanding of entry requirements and a carefully articulated strategy. Many European financial institutions are examining merger and acquisition opportunities in other European countries as an entrée into new markets and an opportunity for expansion. The long-awaited cross-border consolidation of Europe’s retail financial services firms likely will accelerate in the years ahead. Survey respondents see cross-border consolidation as the most important aspect of globalization over the next three years, with 44% citing the trend. Eight of the 12 financial services mergers in the past two years with a European firm as the acquirer have been cross-border retail banking deals, including Grupo Santander’s $15.8 billion acquisition of Abbey National in 2004 and UniCredito’s 2005 nearly $19 billion purchase of HypoVereinsbank. By 2010, hundreds of banks may have vanished and a small group of
Pan-European giants may dominate the landscape, according to a recent Deloitte Research report, *A New Playing Field: Creating Global Champions*. The political, regulatory and cultural obstacles that have blocked European mergers in the past are finally eroding. The European Union supports removal of regulatory barriers to such deals, UK and German regulators have raised no objections to recent deals, and some European courts have opposed discriminatory tax treatment of cross-border entities by national authorities. Favorable capital treatment for diversified businesses under Basel II may encourage more deals. Additionally, huge price discrepancies for banking services across Europe have created demand for lower prices and a climate ripe for more competition in certain markets at the expense of established national players. Looking at new markets outside of Europe, most financial firms are choosing acquisitions or joint ventures to gain access to an established customer base. Numerous foreign entities have acquired stakes in Chinese banks, including Royal Bank of Scotland, ING, Deutsche Bank, HSBC, Citibank, Commonwealth Bank of Australia, Merrill Lynch, Goldman Sachs and Allianz. HSBC’s strategy melds organic growth and acquisition. HSBC has 12 branches in China and expects to own about 20 in 2010, according to *The Banker* magazine. In 2004, it bought a 19.9% stake in Bank of Communications, China’s fifth largest bank, gaining access to 2,400 branches in 137 cities. Stephen Green, group chief executive of HSBC Holdings who will become group chairman on May 26, 2006, says that HSBC will use its own network to provide commercial mid-market and high-net-worth banking services in major cities and work with the Bank of Communications network to serve the burgeoning domestic retail and consumer markets. HSBC has also acquired a 19.9% stake in Ping An, China’s second largest life insurer. Credit Suisse has identified six target Asian markets and tailored its growth strategy to each market. Together with Industrial and Commercial Bank of China (ICBC), it formed a joint venture to offer the first bank mutual fund in China, investing in stock and money markets. The other target markets are India, Hong Kong, Singapore, Taiwan and Korea, according to Clayton Coplestone, head of channel management and sales, non-Japan Asia, for Credit Suisse’s asset management business. No matter how big and global the institution, it must adapt its distribution strategy to individual markets. “I would call it ‘glocalization,’” says Coplestone. “At the end of the day, what happens in Asia is very different from what’s happening in Europe, which is very different from what’s happening in the States. Globalization will affect the manufacturing end. I’m not sure it’s going to have any significant impact at the distribution end.”

**Offshoring**

Offshoring has become a competitive fact of life for financial institutions. A 2005 Deloitte Research report, *Global Financial Services Offshoring: Scaling the Heights*, indicates that the offshoring boom has expanded into many countries, perhaps most prominently India, the Philippines, Malaysia and China. Our offshoring report estimates that there could be money left on the table. According to the findings, the industry as a whole could triple the cost savings from its offshore operations. Using the sample of Deloitte Touche Tohmatsu’s Global Financial Services Industry annual benchmark, the participants could reduce their annual cost base by up to $16 billion – tripling current
savings of around $5 billion. The additional benefits would come from two key sources. First, scaling headcount from around 3.5% of total headcount offshore with average cost savings of 38% to the current best practice of 6.7% of total headcount could yield 60% cost savings. Second, efficiency gains could be created by expanding the scope of operations to “full service,” which means relocating all types of functions from IT and back office, to middle and front office activities. Though some institutions have retreated from offshore call centers, companies generally add more functions, often full-service, after several years of offshoring a single function. Large institutions are naming heads of global offshoring or outsourcing, a sign that offshoring is maturing. Increasingly, the industry is moving away from outsourcing toward captive operations or a hybrid approach of captive and outsourced functions. HSBC has expanded its offshoring beyond basic processing into research and IT development and has only captive operations, building up operation sectors in India, Malaysia, the Philippines, Sri Lanka and China. “The fact that activities are now done somewhere like India or Sri Lanka instead of the US, Canada or UK doesn’t make it any less an integral part of our business,” says HSBC’s Stephen Green. Language can be a barrier to large-scale offshoring. To save costs and centralize its internal systems development and back office, Fidelity has set up an English-language regional service hub in New Delhi and Bangalore. It may look elsewhere for a hub that can handle its Asian-language back office and is moving some functions to Sydney. To succeed at offshoring, firms must manage four key elements: complexity, compliance, culture and cost. Focusing on these elements is the best way to maximize the performance and value of offshore operations. Offshoring adds an element of geographic challenge to regulatory compliance and risk management that must be managed as effectively as onshore compliance. In focus groups on the potential for offshoring and outsourcing, clients of Charles Schwab have voiced concern about the security of money and records. “This is my money, and I want to make sure my money and my records are safe and secure,’ and they don’t necessarily believe or know that those safeguards may be overseas or in somebody else’s hands but they do look for that from us,” says Christopher V. Dodds, Schwab executive vice president and CFO. Our research indicates that offshore results often fall off sharply after the third year as firms start to take the benefits for granted. Institutions need to make sure they have strong managers building and running offshore operations and that the culture extends beyond traditional boundaries to include vendors and alliances. Additionally, rotating top staff can help maintain a mix.

**Looking ahead**

To sustain profitable growth and maintain a competitive advantage, financial services firms will need to embrace consolidation and seek opportunities in new markets, tailor cutting-edge technology and innovative practices to deliver a unique, focused customer experience, adapt an enterprise-wide approach to risk management, employ leading practices when addressing regulatory compliance and focus on meeting the needs of retirees.
How different will the financial services industry look in 2010?

It will be more global. The most successful players will hone their strategy and establish themselves profitably in key overseas markets. The European banking market will have seen increased consolidation and foreign firms will continue to build in China and other Asian markets. Greater scale in offshoring operations and development of full-service capabilities will bring further savings and more reliance on captives or captive/outsource hybrid models. Technology will be the centerpiece of a customer-focused strategy. Personalization will become increasingly important as firms exploit technology to broaden and deepen the retail relationship, becoming more effective at offering and delivering useful products and services. Electronic trading for institutions will predominate, with platforms that provide trading scenario analysis, risk modeling and performance management reporting. While the regulatory landscape will still be fragmented, the most successful firms will be able to manage compliance costs more efficiently. They will articulate, disseminate and enforce an ethical code throughout the business, starting at the top and encompassing all management. They will involve the compliance function in the business, clearly define roles in the compliance function to eliminate costly overlap, roll out a uniform methodology for documenting risks and testing controls and develop knowledgeable local talent. ERM will be the standard framework for financial institutions in integrating a view of all risks and relating risks to business objectives. The CRO role will be closely aligned with senior management. The baby boomer generation will have started to retire. For the majority, defined contribution plans, rather than defined benefit plans, will be the primary form of retirement savings. As this wave of retirees continues for the next 20 years, and as these retirees age, the need for advice and products to aid retirees drawing down assets in the face of uncertainty will grow more and more acute.

INDIA

India's financial services sector is in the process of rapid transformation. Reforms are continuing as part of the overall structural reforms aimed at improving the productivity and efficiency of the economy. The financial services industry can be broadly divided into banking, capital markets (asset management/mutual funds and portfolio investors), insurance companies and non-banking financial intermediaries/institutions.

In recent years, the business landscape in India has changed dramatically as the country has opened up its economy and delivered significant rates of growth. But, according to Russell Parera*, to take advantage of them, companies will need detailed local knowledge and operating models that recognize the particular needs of Indian customers. There are many reasons why India is emerging as an attractive investment opportunity for global financial services providers. One key reason is its sheer size. India has a massive domestic market and a population that is relatively young and becoming increasingly wealthy. As a result, more and more money is moving into savings and investments – fertile ground for wealth managers. India also has outstanding human resources, with large numbers of highly educated young people who speak good English. India exports
talent around the world – not only in IT, but also across the board, including specialist areas of financial services like risk management.

Banking

Banking today has assumed a technology-intensive and customer-friendly face with focus on the ease and speed of operations. The sector is set to witness the emergence of financial supermarkets in the form of universal banks providing a suite of services from retail to corporate banking and industrial lending to investment banking. The government, through the MoF, is responsible for the policies of the financial system, and also plays an important role in the domestic banking system through its ownership and control of the 28 PSBs. Prior to the reforms in 1991, India's banking system was almost entirely owned by the government, except for about 22 private sector banks and foreign banks. The financial reforms of 1991 led to the banking system's movement from a totally administered sector into a more market-driven system. The reforms included progressive tightening of prudential norms for asset quality and capital adequacy (benchmarking international norms), deregulating interest rates, liberalizing the entry norms for new intermediaries and developing new institutions. The entry of the new private sector banks has brought about increased competition, though PSBs still continue to dominate the banking system. This also resulted in a significant improvement in the level of technology employed by banks and in their customer service standards. The Banking Regulation Act, 1949 provides the legal and institutional framework for the banking industry in India. RBI is entrusted with the responsibility of regulating and supervising the banking system in India and is governed by the RBI Act, 1934. RBI also regulates non-banking finance companies and key financial institutions, and jointly supervises the urban cooperative banks along with the respective state authorities. It acts as the banker to the government and manages the latter's internal

The banking sector has been a key contributor and driver in India’s vigorous economic growth, both supporting and benefiting from the combination of strong capital investment, a consumer finance boom and increasing levels of credit. The result has been increased penetration of fee based and third party products, like bancassurance and mutual funds, and expansion into new sectors like Retail and SMEs. This dynamic and growing business environment, combined with relatively low non-performing assets (NPAs) and stronger provisioning and capitalization, has made Indian public sector and private banks very attractive to global investors looking at emerging markets. However, Indian banking continues to be dominated by the public sector and has overseas footprint both organically and through acquisitions.

emerging as an attractive investment opportunity for global financial services providers. One key reason is its sheer size. India has a massive domestic market and a population that is relatively young and becoming increasingly wealthy. As a result, more and more money is moving into savings and investments – fertile ground for wealth managers. At the same time, the legal, regulatory and tax systems are reasonably well established and have a recognizable framework, largely consistent with many other parts of the world. As a result, companies who come to India find it relatively easy to understand and operate
within the business environment, which in turn enables them to operate business models that generate predictable profits. In short, companies that come to India generally make money. India also has outstanding human resources, with large numbers of highly educated young people who speak good English. India exports talent around the world – not only in IT, but also across the board, including specialist areas of financial services like risk management. The banking sector has been heavily regulated, with strict controls on the activities of foreign banks. Despite the steps that have been taken towards liberalization, private sector and foreign banks currently account for less than a quarter of the market. The banking sector is fragmented, with a large number of smaller sized banks, none of which have the scale to compete on a global basis. But India’s banking sector is now set for a period of significant change and is expected to attract new investment opportunities for foreign banks. The government, which wants to create banking conglomerates that can compete on a global stage, has recognized the need for further liberalization and has drawn a ‘roadmap’ for the presence of foreign banks in India, as well as guidelines on the ownership and governance of private sector banks. The roadmap continues to set some limits to the activities of foreign banks in the period to 2009, after which they will have far greater freedom – especially in acquisitions. In the short to medium term, there is expected to be significant consolidation as domestic banks position themselves for increased competition. Some Indian banks are also increasingly looking to increase their overseas footprint both organically and through acquisitions. changed in March 2000 with the passage of the Insurance Regulatory and Development Authority (IRDA) Bill, lifting all entry restrictions for private players and allowing foreign players to enter the market with a 26 percent equity cap. Since then, some 20 new private sector players have entered the market and their experience has been positive. With moves to increase the foreign equity cap

Insurance

With the largest number of life policies in force in the world, insurance represents another huge opportunity for the financial services sector in India. Currently worth some US$15 billion – US$19 billion in life insurance and US$4 billion in other insurance – the insurance business is growing at the rate of 15–20 percent a year. At the same time, nearly 80 percent of the Indian population are without life insurance cover, and health insurance and non-life insurance continue to be below international standards. There is enormous potential for growth. Until five years ago, all insurance was provided by the public sector. The insurance sector moves to increase the foreign equity cap to 49 percent, the market is now set to become even more attractive. Until now, premium rates for most general insurance policies have come under the purview of the government appointed Tariff Advisory Committee, but regulations over the price structure are expected to be abolished in the next couple of years. This will provide a competitive opportunity for firms with superior risk management skills to win additional market share. Revised capital and ownership guidelines for health insurance are expected and in
addition, over the next six months it is hoped the government will bring forward proposals for opening up the pensions market – creating yet another opportunity.

Insurance Companies

The insurance industry in India was traditionally a domain of the government owned insurance behemoths such as the Life Insurance Corporation in the life insurance segment, and the General Insurance Corporation and its four subsidiaries and the Export Credit and Guarantee Corporation in the non-life insurance segment. In August 2000, the insurance sector was opened up to private participation and since then, 13 new life insurance and eight new general insurance companies have entered the market as joint ventures with major global insurance companies. The IRDA, which was established under an act of the Parliament, regulates the insurance and reinsurance business in India. During 2004-05, life insurance companies underwrote a first year premium of Rs 253.4 billion, representing a 35.75 per cent growth over the previous year. Further, 26.2 million policies were underwritten during the year. In non-life insurance, the total gross premium income during 2004-05 was Rs 180.95 billion, a 13 per cent increase over the previous year. Life Insurance Corporation dominates the life insurance sector with a life insurance fund of over Rs 2,000 billion (US$ 45.59 billion) and a market share of 78.07 per cent during 2004-05. The performance of the private sector players has been robust, and their market share the in the premium has increased to 22 per cent in 2004-05 compared with 13 per cent in 2003-04. In non-life insurance, the share of private insurers has increased to 20 per cent in 2004-05 compared with 14 per cent in 2003-04.

A financial system, which is inherently strong, functionally diverse and displays efficiency and flexibility, is critical to our national objectives of creating a market-driven, productive and competitive economy. A mature system supports higher levels of investment and promotes growth in the economy with its depth and coverage. The financial system in India comprises of financial institutions, financial markets, financial instruments and services. The Indian financial system is characterised by its two major segments - an organised sector and a traditional sector that is also known as informal credit market. Financial intermediation in the organised sector is conducted by a large number of financial institutions which are business organisations providing financial services to the community. Financial institutions whose activities may be either specialised or may overlap are further classified as banking and non-banking entities. The Reserve Bank of India (RBI) as the main regulator of credit is the apex institution in the financial system. Other important financial institutions are the commercial banks (in the public and private sector), cooperative banks, regional rural banks and development banks. Non-bank financial institutions include finance and leasing companies and other institutions like LIC, GIC, UTI, Mutual funds, Provident Funds, Post Office Banks etc.

The banking system is, by far, the most dominant segment of the financial sector, accounting as it does, for over 80 per cent of the funds flowing through the financial sector. The aggregate deposits of the scheduled commercial banks (SCBs) rose from Rs.5,05,599 crore in March 1997 to Rs.11,03,360 crore in March 2002 representing a rise of 17 per cent. During the same period, the credit portfolio (food and non-food) of SCBs grew from Rs.2,78,401 crore to Rs. 5,89,723 crore, i.e. by 16 per cent. The net profits of
SCBs witnessed a noticeable upturn from Rs.6,403 crore in 2000-01 to Rs.11,572 crore in 2001-02. The extent and coverage of the banking system can be gauged from the fact that the number of branches of SCBs grew from 8045 in 1969 to 66,186 in June 2002. While rural branches constituted 49 per cent of the total in 2002, semi-urban branches accounted for 22 per cent, urban branches accounted for 16 per cent and metropolitan branches accounted for 13 percent. As regards the capital market, the resource mobilization from the primary market by non-government public limited companies has declined in the recent past from the high levels witnessed between 1992-93 and 1996-97. Resource mobilization of these companies in the public issues market stood at Rs. 5,692 crore in 2001-02 registering an increase of 16.4 per cent over the amount mobilized during the previous year. The public issues market has been dominated by debt issues both in the private and public sectors in the recent past. In recent years, private placement has emerged as an important vehicle for raising resources by banks, financial institutions and public and private sector companies. Such placements continued to dominate the primary market although the pace of growth of the private placement market has slackened during the last two years. Resource mobilization by mutual funds is an important activity in the capital markets. Although there has been a decline in the net resource mobilization by mutual funds to the extent of 28 per cent during 2001-02, according to SEBI, outstanding net assets of all mutual funds stood at Rs.1,00,594 crore as at end-March 2002. The strong potential of the capital market as an area of resource mobilization needs no emphasis and this segment of the financial sector would continue to play a significant role in the future.

**Asset management**

Asset management has all the necessary elements in place to make this an attractive opportunity with current low penetration providing opportunities for growth. For example, India benefits from strong and relatively mature capital markets. Trade in dematerialized shares (demat) started in 1996 and almost all trades are now in demat form. Trading is also in electronic form. A world class T+2 environment for the settlement of stock deals was introduced in 2003. And turnover on the National Stock Exchange compares favorably with some of the largest exchanges in the world.

**Offshoring and outsourcing**

No discussion of India is complete without acknowledging how the outsourced services it provides have enhanced the competitiveness of many Western firms. Initially, firms offshored back office and support services to save money; but they have sustained and expanded these operations because of quality and other competitive considerations. The financial services sector has been one of the leaders, offshoring a wide range of activities at every stage of the value spectrum from call centers to highend research for investment banking. Nor is the growth in offshoring slowing down appreciably. Current revenues of US$3.6 billion are expected to reach US$17 billion by 2008 as more and more companies look to place more and more of their business functions in India.
Capital Markets

Indian capital markets have witnessed a transformation over the last decade and India is now placed among the mature markets of the world. Securities Regulatory Authority. The SEBI was established as a statutory body in 1992 to regulate and promote the development of the Indian securities market and to protect the interests of small retail investors. SEBI regulates the functioning of the Indian capital markets and issues detailed guidelines concerning capital markets, disclosures by public companies and investor protection. SEBI also formulates regulations to govern various intermediaries such as brokers, portfolio managers, merchant bankers, etc. as well as regulates the mutual fund industry, portfolio investments by FIIs and venture capital investments. Mutual Funds. With the entry of private sector funds in 1993, a new era started in the Indian asset management industry, giving the Indian retail/corporate investors a wider choice of fund families. Overall assets under management grew from Rs 1396.2 billion at end-March 2004 to Rs 1495.54 billion at end-March 2005. As at end-September 2005, they had further increased to Rs 2016.69 billion. The 2004-05 saw a record number of 97 schemes being launched in one year. Traditionally, the Unit Trust of India was the dominant player in the industry. However, over the years, private sector funds have grown steadily, and now they comprise the largest segment in the industry. There were a total number of 38 mutual funds as at end of September 2005. The sector is simultaneously witnessing consolidations and expansion.

Foreign Institutional Investors.

India has, of late, generated a high level of interest among FIIs on account of its deep and liquid stock market and the relatively high returns generated by it. This has resulted in a marked increase in the number of FIIs operating in India and the total foreign portfolio investment. The number of FIIs registered with SEBI increased from 540 at end-March 2004 to 685 at end-March 2005, and 793 at end-September 2005. The total investment of FIIs in debt and equity increased dramatically from US$ 25.75 billion at end-March 2004 to US$ 35.93 billion at end-March 2005, and US$ 40.35 billion at end-September 2005. While the portfolio investments of FIIs have traditionally been skewed in

Opportunities and challenges

India is undoubtedly a country where profits can be made. According to India’s Finance Minister, over 82 percent of foreign companies operating in India are profitable. Growing individual and corporate wealth and increasing infrastructure and other investment are combining with deregulation and liberalization to create opportunities right across the financial services sector. But there are also challenges. India’s infrastructure is widely recognized as requiring significant upgrading and development and is increasingly becoming a focus area. India is a large and complex country where local knowledge is essential. Why people buy – and what sells – varies from place to place. Anyone entering the Indian market needs to understand these differences. Another critical success factor
will be getting the distribution model right. While foreign financial services organizations may easily recognize the legal, regulatory and tax framework within which they have to operate, it will take more effort for them to tailor their offer and business processes to Indian needs. To take a simple example, the average loan in India is smaller than elsewhere, and coupled with a vast, dispersed geography, banks will have to think hard about creating a lending distribution model that is both innovative, efficient and cost effective. All that being said, the profit opportunities are well worth the effort of arriving at a detailed understanding of how to do business in India. The elephant is on its feet and looking for partners!

Stock markets

Strong liquidity inflows have helped Indian stock markets outperform most emerging markets in the 2005. It is not just foreign fund flows, which are driving markets up, even domestic investors are pouring money into equities. India's benchmark share index crossed 11,000 points for the first time on March 21, 2006, on the back of robust foreign fund inflows and a move by the government toward greater capital account convertibility.

The Indian markets have also out-performed most of the other major regional markets like South Korea, Taiwan, Thailand and Singapore. The Sensex topped the gainers chart with a 16 per cent return, Singapore rose 6 per cent, Thailand gained 2.3 per cent, Taiwan rose 1 per cent, while Korea was down 3 per cent during the year 2005. Foreign institutional investors’ (FIIs) net investments in the domestic equity markets touched US$ 3.20 billion on March 8, 2006. In comparison to the same period last year, FIIs had pumped in US$ 2.8 billion. India's popularity among investors can be gauged from the fact that the number of FIIs registered with SEBI has increased from none in 1992-93 to 528 in 2000-01 to 803 in 2005-06. In 2005 alone, 145 new FIIs registered themselves, taking the total registered FIIs to 803 (as on October 31, 2005) from 685 in 2004-05.

Mutual Funds

The assets under management (AUM) of the Indian mutual fund industry has gone up by 33 per cent at US$ 44 billion in December, 2005, as against US$ 33 billion in the corresponding period last year. In 2005, the number of fund houses with assets under management (AUM) of more than US$ 2.2 billion has risen to seven with at least three more on the verge of joining the elite club. According to data available with the Association of Mutual Funds in India (Amfi), the bank-sponsored fund houses have AUM of US$ 8.6 billion, the institution-led fund houses have AUM of US$ 1.2 billion and the private sector MFs -- both Indian and foreign -- have an AUM of US$ 34 billion.
Non-Banking Financial Institutions

*NBFCs.* NBFCs provide loans and hire-purchase finance, mostly for retail assets. NBFCs are required to be registered with RBI, which has extensive supervisory and regulatory powers over them. The total assets of NBFCs (excluding residuary NBFCs) amounted to Rs 377 billion (US$ 8.7 billion) in March 2003. *Housing Finance Companies (HFCs).* As the name suggests, the primary objective of these companies is to extend finance to the public for housing purposes. The sector was earlier dominated by Housing Development Financial Corporation (HDFC), which had a 66 per cent share in 1998. However, large banks have rapidly gained market share in the last two years reducing HDFC’s share to an estimated 42 per cent in 2002. There are a total of 45 registered HFCs (of which 23 can accept public deposits) with the National Housing Bank. Total assets of all registered HFCs (having an asset base of more than Rs 100 million) amounted to Rs 430.53 billion (US$ 10 billion) as at March 2003. *Credit Rating Agencies.* Credit rating companies in India rate a wide range of debt securities including quasi-government and municipal securities; corporate debt, including bonds and commercial paper; and asset-backed and other structured finance securities. They also rate mutual funds on their performance and the state governments on their power sector reforms. CRISIL is the country’s leading rating agency, and others are ICRA, CARE, Fitch and Duff & Phelps. Moody's and Standard and Poor, the leading global rating agencies are strategic investors in ICRA and CRISIL respectively. *Venture capital funds.* Though venture capital funds have been active in India, their visibility has increased over the last year or so with several large funds looking actively at investments in India. Venture Capital Funds (VCFs) and private equity investors invested an estimated US$ 1.1 billion in India in 66 India-based companies in 2004. At end-March 2005, there were 50 VCFs and 14 Foreign Venture Capital Investors (FVCIs) registered in India. Their number has increased during the first six months of 2005, bringing the total number to 62 VCFs and 30 FVCIs registered in India. The SEBI regulates the registration and operations of VCFs in India through the SEBI (Venture Capital Funds) Regulations, 1996 which apply to domestic VCFs; and SEBI (Foreign Venture Capital Investor) Regulation, 2000 which apply to FVCIs.

Other Aspects of the Financial Services Industry

*Key Stock Exchanges.* India has 22 recognized stock exchanges, which operate under government-approved rules, bylaws and regulations. These exchanges constitute an organized market for securities issued by the central and state governments, public sector companies and public limited companies. India has modernized the operations of its stock exchanges through the introduction of screen-based trading. The Stock Exchange, Mumbai (BSE) (earlier known as Bombay Stock Exchange) was hitherto India's premier stock exchange. However, the National Stock Exchange (NSE), which commenced operations in 1994, and which provides nationwide trading facilities to investors through an established nationwide information-technology network, now executes a higher proportion of the trades transacted on the stock exchanges. In addition, NSE is also the primary exchange for debt securities. SEBI has initiated the process of demutualization
(segregating the ownership, management and trading rights) of stock exchanges for ensuring better functioning of stock exchanges and introducing transparency in their operations. The process has been completed for BSE, which has now started working as a company.

**Listing Requirements.** Public limited companies are not statutorily required to list their shares on a recognized stock exchange. However, companies must be listed on a stock exchange if their shares and debentures are offered to the public for subscription. For initial public offerings, companies must abide by the stock exchanges' requirements to have their shares admitted, and if a company is not admitted to the exchange, it must refund the amounts received from subscribers. Consequently, companies should apply to one or more recognized stock exchanges for a listing before issuing a prospectus.

**Investor Protection.**

In addition to the SEBI regulations on investor protection, the Companies Act, 1956 and the Securities Contracts (Regulation) Act, 1956 also contain provisions for protecting the interests of investors. Under the SEBI regulations, insider trading is punishable in certain specified circumstances. SEBI is streamlining the guidelines governing takeovers, public issues and disclosure norms to introduce increased transparency in the capital markets. Aggrieved investors may seek redressal by writing to SEBI and informing the concerned stock exchanges. They may also file complaints with the district forum, state commission or national commission established under the Consumer Protection Act, 1996.

**A Future Perspective for Indian Financial System**

The basic emphasis of the Indian approach remains the creation of an enabling environment so as to foster a deep, competitive, efficient and vibrant financial institutions and markets, with emphasis on stability. A number of measures have been initiated to achieve convergence with international best practices. Keeping in view fast pace of technological innovations in the financial sector and product development at the international level, attempts have been to bring the financial system at par with such standards. However, while adapting to international standards and trends, special attention is being devoted so as to customise norms and standards keeping in view various country-specific, including institution-specific considerations. As the economy begins to grow rapidly, the process of financial intermediation is likely to increase. However, in the Indian case, the ratio of bank assets to GDP is quite low among developing countries. By comparable international standards, although the financial reach of the system is high, the extent of financial widening is much lower. This would mean that there is a lot of room for credit expansion to take place, which, in turn, envisages enhanced credit appraisal and risk management skills, which is an important challenge. At present, around 76 per cent of the banking sector assets are accounted for by public sector banks, with the remaining being accounted for by private and foreign bank categories. The share of non-public sector banks has been increasing continuously over
the last few years, with a sizeable rise in the market share (in terms of assets) being evident for new private banks. It is not difficult to imagine that the new private banks, with no legacy of economic structure and their ability to leverage technology to produce highly competitive types of banking, are comparatively better placed to outperform their public sector counterparts. This would imply a rise in the market share for this and (and likely) the foreign bank group and accordingly, a concomitant decline in the market share for public sector banks. The scope for this expansion obviously depends on the expansion of the total banking system. As it stands, the intermediation process has been taking place parallel with the development of the capital market. Therefore, the issue remains for public sector banks as to how to adjust the loss of relative market share in an environment where the absolute size of the pie is not expanding rapidly. Moreover, the ability of different public sector banks to cope up with this challenge is likely to be quite different, which is an important issue they would need to address.

An important issue relates to the manner in which public sector banks would cope when Government ownership is reduced to 33 per cent, which is likely to be fructified once the Banking Companies (Acquisition and Transfer of Undertakings) and Financial Institutions (Amendment) Bill, 2000 is passed by the Parliament. In fact, international evidence tends to suggest a significant scaling down of Government ownership in the banking system (Chart 6) in most countries (Barth et al, 2001). In such a scenario, banks will have to embrace modern management and corporate governance practices and acquire higher quality of human capital. Another major concern for the banking system is the high cost and low productivity as reflected in relatively high spreads and cost of intermediation. Both spreads and operating costs, measured as percentage of total assets of banks have generally been higher vis-à-vis developed countries (Hawkins and Mihaljek, 2001).

An important challenge for the banking sector, therefore, remains in transforming
Financial sector in Punjab

Insurance

INSURANCE has thus far been mostly city-oriented. But things are happening in the rural areas where human life and income-generating rural assets need protection, and there is tremendous scope for developing insurance business. This shows up the gross neglect of the rural areas vis-a-vis insurance cover, though since the late-1960s, a silent economic revolution has been on in the villages. Now that the insurance sector is open to the private sector and foreign companies, the Government should pay serious attention to covering the rural areas. While it is true that access to insurance cover depends on the literacy/awareness levels and assured income, well-planned and organised efforts by committed private sector companies can yield rich dividends from the rural areas. This is because:

(1) A large number of rural districts have witnessed significant growth and prosperity;

(2) Access to reliable and authentic data and information has improved considerably, which can enable quick and correct decision-making;

(3) There are specific functionaries and agencies in the rural areas, which can help explore and exploit insurance business in the untapped rural market. The number of families living below the poverty line has considerably declined in Punjab (11.7 per cent)

Rural areas of Punjab have immense potential for insurance providers. Private sector insurance players are now making a beeline to tap the potential in semi-urban and rural pockets of Punjab

The census of 2001 shows that the rural sector in India comprises 72% of the population and generates 26% of the GDP. Thus, the rural sector is important both politically and economically. Naturally, rural insurance has been emphasised since the nationalisation of life insurance business. The government followed a three-pronged strategy for life insurance. Firstly, it targeted the rural wealthy with regular individual policies. Secondly, it offered group policies to those who could not afford individual policies. Thirdly, for the very poor, it offered government-subsidised policies. For non-life insurance in the rural sector, the government has actively pursued specific strategies such as crop insurance and the insurance of farm implements such as tractors and pumps. It was noted in the section on regulation that, after five years of operation, every private sector life insurance company has to achieve a certain proportion of their business in the rural sector. It is a variable and rising proportion, with at least 15% of business in the rural sector after five years. For the Life Insurance Corporation of India (LIC), the requirement is 18%.

The rural and semi-urban life insurance business is expected to touch 20 billion dollars, while the non-life insurance will increase to 15 billion dollars by 2010, an ASSOCHAM study said today. "The study has revealed that rural and semi-urban India shall contribute
35 billion dollars to the Indian insurance industry by 2010, including 20 billion dollars by way of life insurance and the rest 15 billion dollars through non-life insurance schemes.

**Opportunity for banking sector through Remittance: -**

**The recent surge in remittance flows to India**

India has reported a spectacular increase in remittance inflows—from $13 billion in 2001 to more than $20 billion in 2003 (see figure). Several factors account for this remarkable increase. First, the number of migrants has grown sharply. During the oil boom in the 1970s and 1980s, thousands of lowskilled Indian workers migrated to the Persian Gulf countries. In the 1990s, migration to Australia, Canada, and the United States, increased significantly, particularly among information technology (IT) workers on temporary work permits.a Second, the swelling of migrants’ ranks coincided with (a) better incentives to send and invest money .in India’s growing economy and (b) an easing of the regulations and controls, more flexible exchange rates, and gradual opening of the capital account. The elimination of the black-market premium on the rupee and convenient remittance services provided by Indian and international banks have no doubt shifted some remittance flows from informal *hawala* channels to formal channels. Third, nonresident Indians have also responded to several attractive deposit schemes and bonds offered by the government of India. These offer attractive interest rates and an appreciating rupee. Third, nonresident Indians have also responded to several attractive deposit schemes and bonds offered by the government of India. These offer attractive interest rates and an appreciating rupee. While nonresident deposits are conceptually different from remittances (they are a liability item in the capital account), evidence suggests that a large part of such deposits is converted to local currency. For example, for the Resurgent India Bond that matured in 2003, most of the redemption value stayed in India to meet various local currency needs of the nonresident depositors and their families. Nevertheless, remittances in the form of foreign- currency deposits can be speculative and may reverse in the event of deterioration in the investment sentiment.

INDIA was the largest recipient of remittances in the world at $21.7 billion in 2004, followed by China and Mexico at $21.3 billion and $18.1 billion respectively, according to the World Bank's annual Global Economic Prospects (GEP) report for 2006. Of the other South Asian countries, Pakistan received $3.9 billion and Bangladesh $3.4 billion in 2004.

Remittance inflows into India had surged to $20 billion in 2003 from a level of $13 billion in 2001 - mainly on the back of sharp increase in the number of migrants and good response from the non-resident Indians community to several attractive deposit schemes and bonds offered by the Central Government. The GEP estimates that the South Asia region will receive about $32 billion in remittances in 2005, a 67 per cent increase over the levels in 2001. Officially recorded remittances worldwide are estimated to exceed $232 billion in 2005. Of this, developing countries are expected to receive $167 billion, more than twice the level of development aid from all sources. According to Mr Dilip Ratha, one of the co-authors of the report, remittances sent through informal channels
could add at least 50 per cent to the official estimate, making remittances the largest source of external capital in many developing countries. Asked to comment on the estimated remittance inflows for India in 2005, "We expect it to plateau," he said. He however said that certain practices (like exclusionary arrangements) adopted by Indian authorities kept the remittance costs on the higher side. The GEP has said that reducing remittance costs would do more to encourage the use of formal remittance channels than will regulation of so-called informal services. The report has recommended increasing access by poor migrants and their families to formal financial services for sending and receiving remittances. This could be done by encouraging the expansion of banking networks, allowing domestic banks in origin countries to operate overseas, providing recognized identification cards to migrants, and facilitating the participation of micro-finance institutions and credit unions in the remittance market.

**Punjab**

Non-resident Punjabis, who have made their mark abroad, send in huge sums of money annually to relatives back home as remittances, often being the key element to transformation of their financial status and lifestyle. Conversely, back home, in many cases, families of non-resident Indians can't help but be emotionally pained at the physical distance from their loved ones. Rural interiors of the fertile Doaba region in Punjab boast of the largest number of its sons settled abroad, who send in funds for transformation of the landscape and standards of living of the residents. Figures suggest an estimated $21 million (Rs 100 crore) come here every year as remittances. At least one person from each family here, it is said, lives in the developed nations of the West. What they send back for parents or relatives stems from an intrinsic attachment to home, found among Punjabis more than anyone else.
International Punjabi Chamber for Service Industry

IPCSI represents a cross section of NRI professionals, experts, entrepreneurs, visionaries, businessmen, scholars, educationists, writers, authors, besides trade commercial, educational and cultural organizations in countries where they are settled and the domestic corporate to serve as a conduit between them for promoting the Service Industry and the overall cross-cultural relations.

As the services have grown in importance over the past few years all over the world and in most economies employment has shifted from agriculture industry to the services providing sectors, IPCSI has made its main aim to promote the service sector in the northern region particularly in Punjab which has immense potential for the same on account of well developed infrastructure, skilled human resource and the conducive environment which now prevails. To achieve this aim, IPCSI had organized International Convention of NRIs and Indian Corporate with focus on "Business Opportunities in the Service Industry" on 14th-15th Jan 2006 (Parvani Punjabi Divas) and international summit on infrastructure, Housing & Real Estate Development on 4th March 2006, in collaboration with the Department of NRI Affairs, Govt of Punjab.

Objectives

- To serve as Asia's first centre for research and consultancy for Service Industry promotion.
- To work for establishing a Deemed University of Service Industry.
- To work as NRI Club for bringing NRIs, domestic corporate and others on a common platform for sharing their views, expertise and resources.
- To act as Facilitation Centre for NRIs with 24 x 7 service.
- To link Non-Resident Indians, particularly of Punjabi origin with their motherland culturally & emotionally.
- To harness the rich financial, scientific, technical and entrepreneurial resources of the NRIs for developing Service Industry related projects and infrastructure in Northern India for employment generation, having a multiplier effect on the economy.
- To carry out research on NRI contribution for India's economic and social development to their adopted countries.
- To help the Indian Corporate set up Service Industry related projects overseas and develop collaborations/partnerships/alliances with their counterparts in other countries.
- To assist/encourage joint research in Service Industry segments by scholars, academicians, HR practitioners and others in India and overseas.
- To provide consultancy and also prepare
  - Project/Feasibility Reports for setting up Service Industry related ventures in Northern India.
  - To organise annual Conventions/Conferences/Conclave of Non-Resident Indians and Domestic Corporate for promoting mutual business & social interests.
  - To promote NRI visits to Northern India and help offer customized packages especially for religious and pilgrimage sites.
  - To honour NRIs for their outstanding contribution to the Service Industry.
  - To compile & maintain a DataBank of NRIs, especially of Punjabi origin for possible use by domestic Corporate, educationists and others for possible collaborations/partnerships with their counterparts abroad.
  - To facilitate NRIs during their visits to their motherland.
  - To organize student exchange programmes between children of NRIs and Indian students forging stronger emotional and cultural ties.

IPCSI Vision & Strategy for Punjab in 2006

Investment-Infrastructure Development-Employment

Infrastructure Development for Service Industry in Punjab with focus on:

- Job Creation
- Preparing manpower for the jobs created
- Self employment
- Investment/Business by NRIs/Others
- PPP with NRIs for Village Development,
  Service Industry overall development
Event Concept, Planning & Management by

International Punjabi Chamber for Service Industry
(Single Window to channelise Domestic-NRI Investment, FDI & Knowledge Partnership)

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with Department of NRI Affairs, Govt. of Punjab as anchoring Department