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Prof. Ashok Banerjee

Ashok Banerjee, Ph.D., is Professor, Finance and Control, Indian Institute of Management Calcutta (IIM-C). He is also the faculty in-charge of the Financial Research and Trading Lab at IIM-C. His primary research interests are in areas of Financial Time Series, News Analytics and Mergers & Acquisitions.

The Financial Sector Legislative Reforms Commission (FSLRC), in its report of March 2013, has made sweeping recommendations in the regulations of financial sector. There is no need of a regulator if a market is fully under government-control. Wherever a sector is de-regulated, one actually needs a strong and independent regulator. The main functions of any regulator are two- setting up of unambiguous and non-discriminatory rules and arresting market failures. The FSLRC has envisioned nine components of financial regulations- the most important of which is consumer protection. The Commission makes it clear that the Indian Financial Code (the main outcome of the FSLRC report) will apply to only those persons who are engaged in carrying on financial services. Financial services include services such as, sale of securities, acceptance of public deposits, operating investment schemes and providing credit facilities. The Commission also mentions that ‘particular forms of dealings in financial products, such as securities, insurance contracts, deposits and credit arrangements, constitute the rendering of financial services’. Thus, the scope of the financial services, as defined in the FSLRC report, very much includes all types of financial products including derivatives. Therefore, firms/persons engaged in financial services must, according to FSLRC, do more in the pursuit of consumer protection. Clause 85 of the code provides that ‘A financial service provider must exercise professional diligence while entering into a financial contract or discharging any obligations under it’. The code has additional recommendations to the financial service providers while dealing with unsophisticated consumers. Such consumers have the right to receive suitable advice and access to redress agency for redress of grievances. The draft code also empowers the government to expand the list of financial products and services, whenever required. Similarly, the code allows the government to ‘exclude specific financial services carried out by specific categories of persons from the scope of financial services’.

The draft Indian Financial Code favours principle-based laws rather than sectoral and rule-based regulations and claims that this approach is a major departure from pre1 0 0 1 2116048(f)7(i)17TBT1 0 0 11 0 0 1-tg1

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regulators through a specialized Tribunal. Additionally, a strong reporting mechanism is prescribed to achieve accountability. The commission, in its report, has made necessary distinctions between regulations and guidelines. Guidelines are essentially interpretation of regulations and are not part of regulations. Hence, any violation of a guideline would not constitute violation of a regulation. These guidelines serve important purposes and are commonly used when the regulations are principle-based requiring clarity in interpretations. Drawing parallel from the field of accounting regulations, it can be said that such guidelines help explain the regulation better and create moral pressure on the firms to 'adopt' those guidelines.

Unified Financial Authority

for smaller countries. Financial deepening is an important determinant in integrating financial services supervision.[5] Table 1 shows that about 41 % of the nations follow multiple sectoral supervision.

Table 1: Economies with Single, Semi-Integrated and Sectoral Prudential Supervisory Agencies

* Banking supervision is conducted by the central bank

Source: Martin Čihák and Richard Podpiera, 2006, *Is One Watchdog Better Than Three? International Experience with Integrated Financial Sector Supervision*, IMF Working Paper (WP/06/57)

Unified Financial Authority- International Experiences

Singapore is perhaps the earliest country in the world to switch over to a unified financial supervisory body in early seventies of the last century. On the other hand, the financial supervision in China is performed by three bodies- China Banking Regulatory Commission, China Insurance Regulatory Commission and China Securities Regulatory Commission. This is much in line with the present set up in India. Experts on Chinese financial system have opined that China may gradually move towards unified regulatory regime for the financial sector. The UK, surprisingly, have found that the single supervisory structure has not been working efficiently. In the UK, till March 2013, the responsibility of financial

Financial Services Act established a new and independent Financial Policy Committee (FPC) at the Bank of England as its subsidiary. The main objective of the FPC is to identify, monitor and take action to remove or reduce systemic risks with a view to protecting and enhancing the resilience of the UK financial system. The FPC has a secondary objective to support the economic policies of the government. Thus, the UK legislators have sought to empower the central bank (Bank of England). The FSLRC, on the other hand, has recommended that the systematic risk should be managed by the Ministry of Finance (and not RBI) through FSDC. The commission has suggested further reduction of role of the RBI in managing financial sector; (a) it prescribes that public debt management services should be carved out of the central bank and entrusted with the Ministry of Finance (through a new debt management office); (b) it also prescribes that the rules for inward capital flows would be made by the Central Government and the central bank will only be regulating outward flows. Thus, the FSLRC's position on the role of the central bank in regulating financial services is quite contrary to the position taken by the UK legislation. The

Prof. Partha Ray

Partha Ray, Ph.D., is Professor, Economics, Indian Institute of Management Calcutta (IIM-C). Prior to joining IIM-C, Prof. Ray, a career central banker, was the adviser to Executive Director, International Monetary Fund, Washington D.C. during 2007-2011.

It may not be an exaggeration to say that financial regulation is often perceived as a "necessary evil" among the players in the financial market place. In popular psyche, some sort of cat and mouse game is being played between the markets and the regulator(s) whereby faced with a new regulation, market players bring out newer product / practices to evade such regulation; regulators, in the next period, try to bring about a new regulation to end such practices. These positions may reflect caricatured stances but such caricatures bring out the essential truth, however politically incorrect it may be.

In fact, by now it is widely recognized that one of the root causes of the global financial crisis has been inadequate / incomplete regulation of the financial sector. The practice of "light touch regulation" (

While many of these are indeed valid, what is surprising is a lack of appreciation of the strengths of the present Indian financial sector which is largely perceived as bypassing the direct impact of the global financial crisis. It is now widely recognized that Indian banking was mature enough to handle the global financial crisis by design. An approach oblivious to this fact may end up unfixing the things that are already fixed. This is one theme that the present note will pursue.

Interestingly, the FSLRC has noted that, “the world has learnt the lessons of financial instability and therefore provided for an effective and continuous mechanism for addressing issues of systemic risk, as well as, the need for addressing failures of individual entities through resolution”. Is it true? Has the world really learnt the lessons of financial crisis? The current state of flux on financial regulation all over the world and adoption of “business as usual” models in many advanced countries makes such a statement of finality at variance with the existing global reality of confusion and groping for an ideal model of regulation in the dark.

Institutional Set-up of the New Regulatory Architecture

One of the basic issues of regulation is turf-related. Do the regulators talk among themselves? Or, do they suffer from silo mentality? Is there scope of regulatory arbitrage? Unfortunately received wisdom on the mode of financial regulation from the current global financial crisis is far from being conclusive. After all, the crisis showed the limitations of both uni-modal regulation (as the FSA in the UK) and multimodal regulators (as in the US). The FSLRC proposed a financial regulatory architecture featuring seven agencies:

1. The existing **Reserve Bank of India (RBI)** will continue to exist with some modified functions.
2. The existing SEBI, FMC, IRDA, and PFRDA will be merged into a new **Unconfusion and ns.**

Third, the FSLRC noted that currently there are 11 Acts governing various public financial institutions.[6] In view of the large number of acts behind the establishment of public financial institutions, the FSLRC rightly recommended the repeal or large scale amendment of all special legislations that "(a) establish statutory financial institutions; or (b) lay down specific provisions to govern any aspect of the operation or functioning of public sector financial institutions".

Finally, while noting that "the requirements of independence and accountability of financial regulators are the same across the financial system" the FSLRC recommended a unified set of provisions on financial regulatory governance for all areas of finance. This is clearly at variance with the widely held view that banks are special in the sense that they are overleveraged entities and are backed by public deposit insurance.

Working Group (WG) on Banking under the FSLRC

With a view to outlining and studying comprehensively the banking sector in India, the FSLRC constituted a Working Group (WG) on banking under the Chairperson of Mrs. K.J. Udeshi, former Deputy Governor of the RBI.[7] While reviewing the legal framework of all banking sector entities (both commercial and cooperative banks, as well as the regional rural banks), the WG was mandated, *inter alia*, to suggest ways and means to ensure unification and harmonization of the legal and regulatory treatment of these banking sector entities, and to identify legal mechanisms for obtaining equal treatment, regardless of ownership and nationality on questions of competition policy, mergers, take-overs, and governance. These apart, the WG reviewed the legal framework through which "the regulatory agency would write subordinate legislation on issues of ownership, governance, and compensation of banks and addressing consumer protection, resolution, systemic risk and prudential regulation in banking." The WG delved into issues like definition of banking, level playing field and equal treatment, consolidation in banking, ownership, governance and compensation, holding company structure, recovery of debts and securitization. Some of the recommendations of the Working Group have far-reaching significance for the banking industry.

While defining a bank, apart from deposit accepting activity of a financial entity the WG has emphasized access to clearing arrangement and the repo window of the RBI.

At present the co-operative banking sector has a complex regulatory structure and comes under the dual control of the RBI as well as the State Governments (the Registrar of Societies). To deal with this problem of dual control the WG recommended the creation of a new organization structure for urban co-operative banks, consisting of a Board of Management (BOM) in addition to the Board of Directors (Board). While the Boards would be regulated and controlled by the Registrar of Co-operative Societies, they would establish a BOM, which shall be entrusted with the responsibility for the control and direction of the affairs of the Bank assisted by a Chief Executive Officer (CEO) who shall have the responsibility for the management of the Bank.

[6] These are: (1) the State Financial Corporations Act, 1951; (2) the State Bank of India Act, 1955; (3) the Life Insurance Corporation Act, 1956; (4) the State Bank of India (Subsidiary Banks) Act, 1959; (5) the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970; (6) the General Insurance Business (Nationalization) Act, 1972; (7) the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980; (8) the Export-Import Bank of India Act, 1981; (9) the National Bank for Agriculture and Rural Development Act, 1981; (10) the National Housing Bank Act, 1987; and (11) the Small Industries Development Bank of India Act, 1989.

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As far as the regulatory framework of NBFCs is concerned, the WG recommended while deposit taking NBFCs will fall within the regulatory purview of the RBI, the class of NBFCs that do not accept deposits from public will be regulated by the Unified Financial Authority (UFA). The WG further noted that there must be ring-fencing of banks vis-à-vis other non-bank entities.

business environment rather than continuing with the current varying polices of depending on sectors and unnecessary complexity. It may be reasonable to have investment limits to vary by industry sector and conditions have been attached to individual licenses for reasons which many find inconsistent. FSLRC's arrangements would provide unified treatment of financial firms for prudential reasons. FSLRC's recommendations would create specialized administrative courts to review violations of financial regulations which is a very important step and provide a leg up to the financial markets.

The Committee tries to downsize the central bank and this may not be a good idea in the long run. The Commission's recommendations would rewrite otiurati " wnd ṻ c – נ Ӂ א oǑMrn m d isoc