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Editorial

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The present issue looks at the ramifications of the recommendations of the Srikrishna Committee's report on financial sector legislative reforms. The issue starts with a brief background note on the Financial Sector Legislative Reforms Commission (FSLRC). The April 2013 issue focuses on three areas of the commission's report- (a) consumer protection and justification of principle-based regulations; (b) implications for the banking sector; and (c) implications for the debt market.

It cannot be exaggerated that the report of the FSLRC is quite radical and it draws heavily on the practices and experiences of other countries which have embarked on similar reforms for the financial sector. The commission has done a commendable job in completing the report in a record time of 24 months. One of the radical recommendations of the Commission is to unify multiple regulatory bodies into a single overarching body. This has generated mixed reaction. However, another recommendation of the Commission has already attracted severe criticisms from different quarters- 'suggestions to have the government formulate policy relating to forex inflows while the RBI does likewise with outflows'. It is opined that the FSLRC report has given more power to the Ministry of Finance and at the same time reduced the role of RBI.

There is already pressure on the Ministry of Finance to accept the major recommendations of the FSLRC report in view of massive fraudulent practices of Chit funds affecting millions of hapless 'unsophisticated consumers'. Some have even surmised that the recommendation of the commission for a unified regulatory body for several financial sectors is the only answer to avoid similar situations. We can only wait and see how much of the report is accepted by the government and thereafter the more important part is how the implementation is done.

I hope you'll enjoy reading the newsletter. Please offer suggestions for further improvement to ashok@iimcal.ac.in

Editor

TABLE OF CONTENTS

THE FINANCIAL SECTOR LEGISLATIVE REFORMS COMMISSION - BACKGROUND 4

UNIFIED REGULATORY AUTHORITY: IS IT DESIREABLE?..5-8

Prof. Ashok Banerjee

THE FINANCIAL SECTOR LEGISLATIVE REFORMS COMMISSION (FSLRC) AND THE FUTURE OF BANKING IN INDIA: WHICH WAY NOW? 9-12

Prof. Partha Ray

THE FINANCIAL SECTOR LEGISLATIVE REFORMS COMMISSION AND ITS DIRECTION FOR DEBT MARKET 13-14

Dr. Golaka C. Nath

The Financial Sector Legislative Reforms Commission- Background

The then Finance Minister, Pranab Mukherjee in his Budget Speech for 2010-11 announced (on February 26, 2010) that,

> "Most of our legislations governing the financial sector are very old. Large number of amendments to these Acts made at different points of time has also increased ambiguity and complexity. The Government proposes to set up a Financial Sector Legislative Reforms Commission to rewrite and clean up the financial sector laws to bring them in line with the requirements of the sector" (para 101; available at http://indiabudget.nic.in/ub2010-11/bs/speecha.htm)".

Subsequently, the **Financial Sector Legislative Reforms Commission (FSLRC)** was constituted by the Government of India, Ministry of Finance *vide* a resolution of March 24, 2011 with Justice (Retired) B. N. Srikrishna as its Chairman. While the members were drawn fairly widely, there was no representation from the existing regulators like RBI or the SEBI; but the Government of India was represented by the Joint Secretary, Capital Markets.[1] After nearly two years, the FSLRC submitted its report on March 22, 2013.

The remit of the FSLRC was to, "comprehensively review and redraft the legislations governing India's financial system", many of which are quite old. The Report noted that there are over 60 Acts and multiple rules and regulations governing the financial sector. Thus, in order to evolve a common set of principles for governance of financial sector regulatory institutions, the FSLRC came up with a draft 'Indian Financial Code' which is non-sectoral in nature and proposed to replace the bulk of the existing financial laws. Justice Srikrishna has rightly noted in his introductory comments that, "foundations of modern financial legal regulatory structures should be erected during peaceful times rather than wait for a crisis to unfold and then embark on a fire-fighting mode of institution building, which would be muddled and fragile".

The FSLRC report is indeed huge with its two volumes spanning over more than four hundred pages and touching various aspects of legislative reforms in the financial sector, as diverse as, structure of the regulator; functions and powers of the regulator; micro-prudential regulation; resolution; capital controls; financial inclusion and market development; public debt management; and financial regulatory architecture.

[1] Other members of the FSLRC were: Justice Debi Prasad Pal, P.J. Nayak, K. J. Udeshi, Late Shri C. Achuthan, Y. H. Malegam, Jayant Varma, M. Govinda Rao, Dhirendra Swarup, Joint Secretary, Capital Markets (Nominee Member), and C K G Nair (Secretary to the Commission). Three Members of the FSLRC could not sign the Report. C. Achuthan passed away on 19th September, 2011; Justice Debi Prasad Pal was seriously ill and Joint Secretary, Capital Markets (Nominee Member) "could not attend the meetings due to other commitments".

Unified Regulatory Authority: Is it Desirable?

Prof. Ashok Banerjee

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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 previous regulatory prescriptions. However, if one looks at the Indian accounting standards (Ind AS), it may be observed that these standards are principle-based and not rule-based. In other words, Indian businesses are already conversant with rule-based regulations and hence the major emphasis of the draft Indian Financial Code in having principle-based regulations is not absolutely new. The FSLRC observes that in India many public sector financial firms (e.g., State Bank of India, Life Insurance Corporation of India) are governed by specific laws and suggests that all such entities be converted into a company under the Indian Companies Act, 1956. The commission claims that this would help enable 'ownership-neutrality in regulation and supervision'. The FSLRC strongly recommends independence and accountability of the regulators. Chapter 11 of the draft code states that all members (excepting nominees) of a regulatory body must be appointed by the Central Government from a list of persons shortlisted by a competent selection committee. The selection committee, while short listing names, must give emphasis to qualification, experience, past achievement, reputation and independence of persons. The FSLRC has also been careful in emphasizing the need for greater accountability of the regulatory bodies. The commission has adopted 'five pathways to accountability', the most important of which is judicial review of all actions of the

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

The main thrust of the commission is to discourage multiplicity of regulatory bodies and instead institute an umbrella body taking care of most of the financial services. Hence, the FSLRC recommends that SEBI (capital market regulator), FMC (commodities market regulator), IRDA (insurance sector regulator), and PFRDA (pension sector regulator) be merged into a single body, the Unified Financial Authority (UFA). The public opinion on this proposal is sharply divided. Many experts believe that such a single agency would make the regulation more effective and clear all ambiguity with regard to overlap areas. These experts also opine that RBI and SEBI have failed in controlling the rampant and unscrupulous growth of chit funds. The regulatory bodies and the state government are debating on whose territory the operations of the chit fund fall. It is said that these unscrupulous entrepreneurs are taking advantage of huge ambiguity in the regulatory space and hence deriving benefits of regulatory arbitrage. Another argument in favour of a single regulatory body is that there are many financial conglomerates which operate in multiple areas of financial sector (e.g., universal banking) and hence 'fragmented supervision may raise concerns about the ability of the financial sector supervisors to form an overall risk assessment of the institution on a consolidated basis, as well as their ability to ensure that supervision is seamless and free of gaps'[2]. There are at times arguments that financial institutions offer very complex and diverse products and hence regulating them by a single agency might be difficult as well as ineffective. Proponents of this view advocate that a distinction needs to be made between financial institutions and financial products. But the counter argument could be that with the evolvement of financial systems, the distinction between financial institutions and products have become blurred and multiple supervisory body for different institutions may create a situation where institutions offering similar products are regulated by different agencies (an example could be the recent tussle between SEBI and IRDA on regulating market-linked products of insurance companies). The third argument, in favour of a single agency supervision system, is that even financial institutions would prefer reporting to a single agency rather than responding to the queries of multiple agencies for different products. 'The existence of a range of supervisory authorities also poses the risk that financial firms will engage in some form of supervisory arbitrage.'[3] The fourth argument favouring a single agency system is borrowed from economics and it is said that a larger and unified regulatory body will derive benefits of economies of scale. It would be possible for a large regulator to adopt finer specialization and save costs through shared infrastructure, administration and support system. A recent study[4] observes that regulatory structure in the financial sector depends on several factors and finds that 'as countries advance to a higher stage of economic development, they tend to integrate more their financial sector supervisory structures.' Thus, although there is increasing trend amongst advanced nations to embrace a unified supervision structure, such structure may not be effective

[2] Richard K. Abrams and Michael W. Taylor,2000, *Issues in the Unification of Financial Sector Supervision*, IMF Working Paper (WP/00/213)
[3] Ibid, page 12
[4] Martin Melecky and Anca Maria Podpiera, 2012*, Institutional structures of financial sector supervision, their drivers and emerging benchmark models*, MPRA Paper No. 37059. Available at http://mpra.ub.uni-muenchen.de/37059/

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

Single Prudential Supervisor for the Financial System (year of establishment)		Agency Supervising Two Types of Financial Intermediaries			Multiple Sectoral Supervisors	
		Banks and securities firms	Banks and insurers	Securities firms and insurers	(at least one for banks, one for securities firms, and one for insurers)	
Australia (1998) Austria (2002) Bahrain* (2002) Belgium (2004) Bermuda* (2002) Cayman Islands* (1997) Denmark (1988) Estonia (1999) Germany (2002) Gibraltar (1989) Guernsey (1988) Hungary (2000) Iceland (1988) Ireland* (2002)	Japan (2001) Kazakhstan* (1998) Korea, Rep. (1997) Latvia (1998) Maldives* (1998) Malta* (2002) Netherlands* (2004) Nicaragua * (1999) Norway (1986) Singapore* (1984) South Africa * (1990) Sweden (1991) United Arab Emirates* (2000) United Kingdom (1997) Uruguay (1993)	Finland Luxembourg Mexico Switzerland Uruguay	Canada Colombia Ecuador El Salvador Guatemala Malaysia* Peru Venezuela, Rep. Bolivariana de	Bolivia Bulgaria* Chile Jamaica* Mauritius* Slovak Republic* 2/ Ukraine*	Albania* Argentina* Bahamas, The* Barbados* Botswana* Brazil* China Croatia* Cyprus* Czech Republic 2/ Dominican Rep* Egypt* France* Greece* Hong Kong SAR* India* Indonesia* Israel*	Italy* Jordan* Lithuania* New Zealand* Panama Philippines* Poland* Portugal* Russia* Slovenia* Sri Lanka* Spain* Thailand* Tunisia* Turkey Uganda* United States*
As share of all countries in the sample (percent)						
33		6	11	9	41	

* 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 regulation and financial stability was bestowed on the treasury, the Bank of England and the Financial Services Authority (FSA). FSA was set up in 1997, combining nine separate agencies, as an integrated supervisor following the examples of Canada, Japan, Germany, Singapore and Switzerland. However, FSA's performance during the financial crisis has been criticized on three grounds- (a) ineffective communication between FSA and the other two regulatory agencies; (b) neglecting macro-prudential supervision before the crisis, and (c) over-emphasising conduct of business supervision over macro-prudential supervision. It was also believed that FSA has been generally ineffective in ensuring consumer protection. The new UK government in 2010 launched fundamental reforms of the financial supervisory architecture which led to recommendations of breaking up the FSA into two bodies- the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA). The recommendations of disbanding FSA were made into laws in the UK through the promulgation of the Financial Services Act, 2012, which came into effect from April 2013. The PRA is set up to implement prudential regulation of deposit-taking institutions (e.g., banks, chit funds etc.), insurance firms and systematically important financial institutions. The FCA, on the other hand, is created to conduct prudential regulation of other financial institutions, consumer protection and regulation of financial institutions' business conduct. The

[5] Ibid, page 19

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 commission could not provide, in its voluminous report, very convincing argument for reducing the role of the central bank.

In the conclusion, it can be said that the recommendation of the FSLRC for merging multiple regulatory bodies into a single independent entity makes two fundamental assumptions: (a) the financial sector in India in general and financial markets in particular have matured and deepened; and (b) the independence of the agency can be ensured. It is to be seen whether the central government accepts the recommendations and more importantly allows the proposed regulatory bodies to function independently.

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The Financial Sector Legislative Reforms Commission (FSLRC) And the Future of Banking in India: Which Way Now?

Prof. Partha Ray

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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" (*a la* Alan Greenspan) simply did not work, the unregulated shadow banking sector became larger than the regulated banking sector, and private financial institutions became so big that they could not be allowed to fail and had to be saved with public money. Thus, as the economies are making serious attempts to come out of the fallout of the global financial crisis, financial sector regulations have undergone significant reviews and changes all over the world. The Dodd-Frank Wall Street Reform and Consumer Protection Act in the US or the Financial Services Act in the UK (which received Royal Assent on 19 December 2012) are illustrations of such attempts. Interestingly, even without being directly affected by the fallout of the financial crisis (as the subprime exposure were almost non-existent for the Indian banks), India initiated such regulatory reviews.

The present note does not look into all the issues / areas, raised by the FSLRC holistically and is much narrow in its treatment. The rest of the note focuses only on select aspects of the banking sector regulation that the FSLRC has recommended.

Basic Postulates of the FSLRC

To begin with, it may be useful to enumerate the basic postulates of the FSLRC that it arrived at after consulting various stake-holders. First, the legislative foundation of India's financial sector has been found to be too complex and cumbersome. Second, the regulatory architecture is too fragmented, "leaving substantial scope for grey areas and overlaps, capture, and bargaining". Third, there is lack of wherewithal for addressing the "issues emanating from the global context of financial development". Fourth, the FSLRC felt that there is a need for strengthening the consumer protection and grievance redress mechanism in financial sector. Fifth, "the current architecture encourages turf battles and conflicts of interest". Sixth, while every regulator should encourage competition in their sector, the FSLRC felt that, "the ultimate responsibility of managing economy-wide competition issues should be left to the Competition Commission". Seventh, there is much to achieve in ensuring consumer protection. It is the opinion of the FSLRC presence of archaic rules in the financial sector led to many unintended consequences, which include, "regulatory gaps, overlaps, inconsistencies and regulatory arbitrage",

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 **Unified Financial Authority (UFA)**.
3. The existing Securities Appellate Tribunal (SAT) will be subsumed into the **Financial Sector Appellate Tribunal (FSAT)**.
4. The existing Deposit Insurance and Credit Guarantee Corporation of India (DICGC) will be subsumed into the **Resolution Corporation**.
5. A new Financial **Redressal Agency (FRA)** will be created.
6. A **new Debt Management Office** will be created with the Ministry of Finance.
7. The existing **Financial Stability and Development Council (FSDC)** will continue to exist, though with modified functions and a statutory framework.

Banking and the FSLRC

As far as banking is concerned, the following proposed changes of the FSLRC are of colossal significance.

First, the FSLRC proposed that the RBI would perform three basic functions, viz., monetary policy, regulation and supervision of banking (in enforcing the proposed consumer protection law and the proposed micro-prudential law), and regulation and supervision of payment systems (in enforcing these two laws).

Second, the proposed unified financial regulatory agency would also take over the work on organized financial trading from the RBI in the areas "connected with the Bond-Currency-Derivatives Nexus", and from the FMC for commodity futures, thus giving a unification of all organized financial trading including equities, government bonds, currencies, commodity futures and corporate bonds.

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.

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[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.

[7] Other members of the Group were: Y.H. Malegam, Janmejaya Sinha, Aditya Puri, Naina Lal Kidwai, Rajiv Lall, Harsh Vardhan, and M.G. Bhide. Representative from any public sector bank (serving officials) was conspicuous by his / her absence.

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.

In case of foreign banks in India, the WG recommended that all such foreign banks set up a wholly owned subsidiary (WOS) in India and do not operate through branches. However, while getting converted from branch to WOS, care needs to be taken so that they do not incur taxation from capital gains, or stamp duty. Furthermore, the WG found flaws with the current mode of operations of banks under bank subsidiary model (BSM) and recommended that there should be a shift towards the financial holding company (FHC) model as a preferred model for financial sector in India.

Tilting towards the Ministry of Finance

The FSLRC has made a number of recommendations for the banking sector with far reaching significance. But what has been its guiding philosophy? Is it grounded in the regulatory reality of the post-global financial crisis world? Early opinions in this regard have been rather critical. The report has come up with a number of dissenting notes. Insofar as banking is concerned, the following two deserve special mention.

It has been alleged that the FSLRC in the name of reviewing the regulatory landscape has moved powers to the Ministry of Finance. It is best reflected in the dissenting note of P J Nayak, member of FSLRC and ex CEO of the Axis Bank, which said:

> "The last 25 years of the evolution of financial sector regulation in India has seen a continual empowerment of regulatory agencies. …The Commission now arrests and partly reverses this directional movement, and *it is with apprehension that one must view the very substantial statutory powers recommended to be moved from the regulators (primarily RBI) to the Finance Ministry and to a statutory FSDC, the latter being chaired by the Finance Minister.* … The concept of a statutory FSDC, and the functions sought to be vested in it, are sensible provisions and will provide much needed co-ordination between regulators, as also the ability to steer the financial sector through periods of systemic risk. *What is worrisome is that the chairmanship of FSDC is with the Finance Ministry, as this could lead to a government creep into the micro-prudential powers of other regulators*" (p. 150, Volume I of the Report of the FSLRC; emphasis added).

On another issue, Y H Malegam, a reputed Chartered Accountant and a long-serving director of the RBI Board, has expressed reservations about shifting regulatory controls over non-banking financial companies (NBFCs) and housing finance companies (HFCs) to unified financial authority (UFA).

Financial laws, like any other laws, are products of history and tend to get shaped by the zeitgeist. Thus, any review of any economic legal structure has to be linked with the macroeconomic structure of the economy. At the current juncture, when the Indian economy is plagued with problems related to excessive fiscal deficits, and the world is looking for alternative models of financial regulation, the approach of the FSLRC to place regulatory powers with the government may be misplaced. After all, regulatory reform guided by a philosophy of fixing everything when all of it is not broken could be counterproductive.

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The Financial Sector Legislative Reforms Commission and its direction for Debt Market*

Dr. Golaka C. Nath

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The Financial Sector Legislative Reforms Commission (FSLRC) report is significant as it tries to address some of the major issues faced by financial markets – specifically jurisdictional overlap and regulatory gap existing today. The FSLRC had a broad mandate to review the institutional arrangements in Indian financial sector regulations. Its report advocates a sweeping reorganization of the country's financial regulation architecture and proposes the by consolidation of regulation to be managed in the form of Unified Financial Authority (UFA).

FSLRC proposes to create a resolution corporation to deal with "too big to fail" problems. It also proposes an independent public debt management agency. The current debt management functions are vested with the Reserve Bank of India (RBI). On earlier occasions, this issue was debated in various forums. The report suggests that RBI should concentrate on monetary policy issues and debt management should be handled by a separate agency. In 2010, a debt mid-office was opened as a cell in Ministry of Finance, New Delhi as a starting point to shift the debt management functions from RBI to a new proposed agency called National Treasury Management Authority (NTMA). This was envisaged in the Report of the Internal Working Group on Debt Management (Ministry of Finance) dated 31-Oct-2008 – commonly known as Jehangir Aziz Committee (who headed the said committee). However, the shifting of the debt management role could not take place as the Government had to grapple with huge borrowings on account of global financial crisis. It was believed that a new agency would find it difficult to manage such huge borrowing programme and hence it was consider prudent to leave the debt management arrangement with RBI.

The proposal has again surfaced in the new report possibly the Committee considered the views of the earlier Internal Report relevant in the changing context. However, given the current situation of high borrowings, serious debate need to be initiated to understand what a new debt management office can do which cannot be done by RBI in its present role as a Merchant Banker for the Government.

The report proposes to streamline the country's system of capital controls that would allow restrictions of capital flows in narrowly defined instances. It proposes that the Central Government would promulgate 'rules' governing capital inflows while the RBI would promulgate 'regulations' governing outflows. It also proposes a clean-up of certain matters related to financial contracts and market infrastructure.

FSLRC recommends for institutional arrangements to deal with future financial crises. This is going to be a big challenge. The report recognizes the need to have clear financial regulations to suit the current

** Personal views of the author only and not the views of his organization*

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 the rules of engagement in economic policy in favor of government. This may bring serious problems given the coalition structure of the Governments in recent years.

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