CHAPTER- X
ANALYSIS OF THE EXISTING STRUCTURES AND CHOICE OF THE REGULATORY MODEL FOR INDIA

After a detailed analysis of different models of regulatory structures followed by countries world over, this chapter undertakes in the Indian context, an overview of various recommendations, formulae suggested over a period of time by various Committees constituted by the Government of India, for the financial market. In particular, this Chapter deals at length the recommendations of Financial Sector Legislative Reforms Commission which has made major recommendations for overhaul of the Indian financial regulatory architecture.

As a result of crisscross of legislative patterns regulating the Indian financial markets, there was an increasingly intensified debate, any, lobbying for merging of regulatory roles. In this respect, there were two reports that had this common theme. One is Percy Mistry Report 168 on recommending Mumbai as “International Financial Centre” and another High Level Committee on Financial Sector Reforms 169 under the Chairmanship of Mr. Raghuram Rajan. Both emphasized on the need to take out most of the regulatory functions from RBI other than its role as monetary authority and banking supervision and placing the same with SEBI to get better synergies and clarity on regulation of financial markets.


Similarly, an Internal Working Group on Debt Management set up in Ministry of Finance recommending a legislative framework for a “National Treasury Management Agency” and “Debt Management Office” had called for merging some of the regulatory functions such as Government Securities market in SEBI from the Reserve Bank of India. It has also been pointed out that RBI performing the role as monetary authority should not be seen undertaking any debt management functions as there is an inherent conflict of role. The Government of India has also recognized the need for creation of separate Debt Management Office. All these take us towards the view whether there is a need to converge all the regulatory roles and create a unified Regulatory structure in India. Interestingly, the need for convergence of roles was raised in the past also in a limited way. In fact, “based on the recommendation of Narasimham Committee on Financial System, 1991, the duality of control on banking system between RBI and Banking Division of Ministry of Finance was ended and the same was placed under a separate autonomous body under the aegis of the Reserve Bank of India. Again in 1998, Committee on Banking Sector Reforms under the chairmanship of M. Narasimham recommended restructuring of the role of BFS”.

The concept of super Regulator was for the first time raised in the Report of Working Group for Harmonizing the Role and Operations of DFIs and Banks under the Chairmanship of SH Khan. It emphasized on the need for creation

---


171 Id.

172 See also Supra note 38.

of a “Super Regulator” to supervise and coordinate the activities of multiple regulators to ensure uniformity in regulatory treatment. Over the years the debate on the need for converging various financial activities under the purview of SEBI has been increasing in intensity. In fact, both Percy Mistry\textsuperscript{174} and Raghuram Rajan Committee reports\textsuperscript{175} and Internal Working Group Report\textsuperscript{176} mentioned supra, emphasized on the necessity of divesting RBI of most of the existing activities other than monetary authority and bank supervision and place those activities under the purview of SEBI.

**Financial Sector Legislative Reforms Committee:**

A Committee under the Chairmanship of Justice Sri Krishna was constituted for the following:

1. Examining the architecture of the legislative and regulatory system governing the Financial sector in India

2. Examine if legislation should mandate statement of principles of legislative intent behind every piece of subordinate legislation in order to make the purposive intent of the legislation clear and transparent to users of the law and to the Courts.

3. Examine if public feedback for draft subordinate legislation should be made mandatory, with exception for emergency measures.

4. Examine prescription of parameters for invocation of emergency powers where regulatory action may be taken on ex parte basis.

\textsuperscript{174} Supra note 88  
\textsuperscript{175} Supra note 89  
\textsuperscript{176} Supra note 90
5. Examine the interplay of exchange controls under FEMA and FDI Policy with other regulatory regimes within the financial sector.

6. Examine the most appropriate means of oversight over regulators and their autonomy from government.

7. Examine the need for re-statement of the law and immediate repeal of any out-dated legislation on the basis of judicial decisions and policy shifts in the last two decades of the financial sector post-liberalization.

8. Examination of issues of data privacy and protection of consumer of financial services in the Indian market.

9. Examination of legislation relating to the role of information technology in the delivery of financial services in India, and their effectiveness.

10. Examination of all recommendations already made by various expert committees set up by the government and by regulators and to implement measures that can be easily accepted.

11. Examine the role of state governments and legislatures in ensuring a smooth interstate financial services infrastructure in India.

12. Examination of any other related issues

The mandate of FSLRC not only includes recommendations for a complete redesign of the financial sector of India, but also the legislation itself. The Commission strongly believes in the approach of writing 'principle based' legislation that would articulate broad principles which do not vary with financial

or technological innovation. Regulators will write subordinated legislation which could either utilize detailed prescriptive rules or be principles-based, depending on the situation and the judgment of the regulator. This combination of legislation and subordinated legislation should yield a body of law that evolves smoothly over time.\textsuperscript{178}

The FSLRC recommendations have taken a middle path when compared to the ‘Christmas tree approach’ or the ‘twin peaks model’. While they have provided for unification of SEBI, FMC, IRDA and PFRDA, they have at the same time kept the banking regulation independent from this unified regulator.

This approach also substantively improves the compliance culture. Under rules-based regulation, there is the risk that financial firms set up complex harmful structures that comply with the letter of the rules.

The Commission would want laws to hold financial firms to a higher standard: that of complying with the principles.

The model of the proposed regulatory architecture will comprise the following agencies:

1. The Central Bank as the monetary authority, banking regulator and payment system regulator.

2. A unified regulator for the rest of the financial sector.

3. A deposit insurance-cum-resolution agency.

4. A public debt management agency.

5. A financial redressal agency.

\textsuperscript{178} Id.

7. A mechanism for coordination, systemic risk, financial development and other issues where the role of multiple agencies are involved (FSDC/similar to FSDC).\textsuperscript{179}

At a conceptual level, it is proposed that RBI will perform three functions: 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. In order to minimize conflicts of interest across these three fields, and to develop specialized skills, the Commission will recommend that the three functions be performed by distinct boards which oversee the three areas of work of monetary policy, payments regulation and supervision, and banking regulation and supervision.

The unified financial regulatory agency, which would deal with all financial firms other than banking and payments, would yield benefits in terms of economies of scope and scale in the financial system; it would reduce the identification of the regulatory agency with one sector; it would help address the difficulties of finding the appropriate talent in government agencies. This proposed unified financial regulatory agency would also take over the work on organized financial trading from RBI in the areas connected with the Bond-Currency-Derivatives Nexus, and from FMC for commodity futures, thus giving a unification of all organized financial trading including equities, government bonds, currencies, commodity futures, corporate bonds, etc. The unification of regulation and supervision of financial firms such as mutual funds, insurance companies, and a diverse array of firms which are not banks or payment providers, would yield consistent

\textsuperscript{179}\textit{Id.}
treatment in consumer protection and micro-prudential regulation across all of them.\textsuperscript{180}

The present SAT will be subsumed in FSAT, which will hear appeals against RBI for its regulatory functions, the unified financial agency, decisions of the Financial Redressal Agency (FRA) and some elements of the work of the resolution corporation.\textsuperscript{181}

The present DICGC will be subsumed into the Resolution Corporation which will work across the financial system.\textsuperscript{182}

The Financial Redressal Agency (FRA) is a new agency which will have to be created in implementing this financial regulatory architecture. It will set up nationwide machinery to become a one stop shop where consumers can carry complaints against all financial firms.\textsuperscript{183}

The Financial Redressal Agency (FRA) is a new agency which will have to be created in implementing this financial regulatory architecture. It will set up nationwide machinery to become a one stop shop where consumers can carry complaints against all financial firms.\textsuperscript{184}

FSLRC promises to endeavour to find a judicious middle road which combines appropriate levels of independence achieved through concrete mechanisms in the law, coupled with an array of accountability mechanisms, through which sound outcomes will come about under Indian conditions. This will yield

\textsuperscript{180} Id.
\textsuperscript{181} Id.
\textsuperscript{182} Id.
\textsuperscript{183} Id.
\textsuperscript{184} Id.
substantial gains for the Indian economy when compared with the present arrangements.

Some of the major observations and concerns which have been expressed on the FSLRC Report are as follows:

1. The Unified Regulator proposed in the IFC (Indian Financial Code) could lead to monopoly of Regulator.

2. It may not be possible to have staff complement that have specialized skill sets in multiple areas of operations.

3. Each market's regulatory structure requires expertise for that sectoral market and a unified regulator recommended in the report would not be able to handle the same.

4. Two decades of empowerment of financial regulators is sought to be reversed with this report.

5. Creation of the Super Authority called Financial Stability and Development Council to be chaired by Finance Minister would effectively take away the independence and expertise of regulators.

6. Principles based sounds good in theory -but difficult to implement it. For collection of margin cannot be on principle such as fairness but only based on quantitative parameters driven by specific rules.

7. The report has suggested a truncated role for RBI. The Central bank of the country have enjoyed a special status, as an expert body over a period of more than 5 decades. The expertise built by RBI in the debt management over a period of time has been phenomenal which it has been managing independent of any influence. Managing Public Debt is a
complex issue and it requires coordination of the monetary policy as well as the fiscal policy and only Central Bank of the country is ideally suited to tackle it.

However, there are equally strong arguments on maintaining the status quo ante. Firstly, already there exists a clear structure of demarcated regulatory tiers for various activities with various regulators and there is no compelling need to change them especially when it is working without any glitches. The country’s financial regulatory system has become highly sophisticated and matured. There is a very good body of regulatory literature built over a period of time born out of a sustained and detailed reforms, some of them at fundamental levels. Change through integration may also take time for end users to understand. So long as the players clearly understand the regulatory jurisdiction of each area of activity and know their responsibilities, it may not be necessary to have an overhaul of the system. Secondly, legal and regulatory structure for various financial activities has been evolved over a period of time and has been found to be working efficiently. In the process, a sound regulatory framework has been created in the country. To change or tamper with the present regulatory structure in the name of benchmarking against the International standards may not be appropriate for the simple reason a time tested model may stand a better scrutiny. A case in point to illustrate this is recent failure of regulatory framework of FSA, U K. An active role by FSA could have helped detect the problems well in time in Northern Rock episode. Resultantly, the FSA functions were ultimately merged with Bank of England based on the recommendation of U.K. Parliamentary Committee.

The Securities and Investments Board changed its name to the Financial Services Authority on 28 October 1997 and it started to exercise statutory powers given to it by the Financial Services and Markets Act 2000 that replaced the earlier legislation and came into force on 1 December 2001. At that time the FSA also took over the role of the Securities and Futures Authority (SFA) which
had been a self-regulatory organization responsible for supervising the trading in shares and futures in the UK.

In addition to regulating banks, insurance companies and financial advisers, the FSA regulated mortgage business from 31 October 2004 and general insurance intermediaries (excluding travel insurance) from 14 January 2005.

Due to the economic crisis of 2008 and subsequent adverse impact on the markets across, trust in financial products has been eroding and is now at an all time low. With the introduction of the prudential regulator and consumer protection and markets authority, UK is said to have created a powerful agency responsible for both consumer protection and the supervision and regulation of financial markets.

This brings Britain more closely in line with other countries such as Australia and the Netherlands that have a double system of regulation. This means that one agency is charged with prudential supervision and the other with consumers' interests at its heart.

It is generally accepted principle that change or review in any regulatory architecture is required to be made only when there exists compelling reasons to do such as failure of the existing system to regulate or contain systemic risks, inability to manage the markets on account of increase of its size or complexities. Unless there are compelling reasons to change the status quo should not be changed as it may instead of solving the problems could create more complexities.

All these take one to the conclusion that a convergence or unified model need not be role model worthy of being pursued. In any case, even with all these recommendations, India still may not be able to achieve a unified structure as the different regulatory structures have been established over a period of time.
and each regulator has gained a reasonable experience in managing its respective area of regulatory jurisdiction. Further RBI, by playing an active and impartial role, as Central Bank of the country, has entrenched well in the regulatory framework as the most experienced and well balanced. It may be required to continue to regulate some markets such currency, Government securities mainly on account of its riding high on roster of credibility. In fact, India escaped the recent financial mayhem that was witnessed world over in the aftermath of Lehman bankruptcy and consequent crumbling down of the investment banks in U S and other countries, mainly on account of a very sound regulatory structures of the country especially Reserve Bank of India. In any regulatory structure whether unified or multiple, there may still exist some deficiencies, as there can be no perfect system without blemishes. Further, even there is no need to have a separate “Super Regulator” over the existing regulatory framework. The concept of “Super Regulator” is already present in a way in most of the regulatory legislations. Since the Central Government has the overriding role in most of the statutes, it acts as a “Super Regulator”. Hence, the best way to overcome this problem would be to make required changes in the existing structure instead of contemplating a radical change to the system. Making radical change to well oiled regulatory structure may become a costly exercise as discussed above.

In conclusion, it is to be stated that the framework of FSLRC provides a detailed roadmap to move the regulatory architecture from silos to a middle path between unified and silos model. But, given the failure of change in model in U. K. it is not known whether the proposed change in India is going to help Indian financial system. Given the expertise gained by each sectoral regulator, it may make sense to leave the structure as it is as there appears to be no compelling reason to change.