

# Financial sector regulation in India

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# The financial sector in India

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- **The regulators**

RBI, SEBI, FMC, IRDA, PFRDA, MoF, HLCC

- **The markets**

Commodities, equity, debt, foreign exchange

- **The players**

Brokers, firms, banks, financial institutions, foreign institutional investors, mutual fund managers, investors, exchanges, depositories, custodians, registrars.

# RBI

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- Set up under the RBI Act, 1935.
- Regulator of deposit-taking agencies.
- Regulator for debt, foreign exchange markets.
- Securities infrastructure for debt, foreign exchange markets.
- Payments system.
- Investment banker for the government.
- Central bank.

# FMC

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- Flows from the FC(R) Act 1952.
- Regulator of commodity derivative markets, commodity derivative brokers.
- FMC regulation is in the form of policy recommendation rather than implementation (which is done by the DCA) or enforcement/punitive action (which is done by the police).
- Plays a role in the development of commodity derivative markets.
- Is an arm of Department of Consumer Affairs.

# SEBI

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- Set up in 1988, as part of the SC(R) Act 1956.
- The first regulator under the SC(R)A, 1956 was the CCI.
- Regulator of anything that is exchange–traded.
- SEBI can set regulatory policy, carry out implementation as well as has the power to enforce regulatory rules and impose punishment on wrong-doing.
- Grievances and appeals to SEBI rulings are heard by the Securities Appellate Tribunal.

# MoF

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- Plays a role in creating regulators.
- Prior to the reforms of the nineties, played the role of supervisor of rules and regulations.
- Legislative work.
- Big picture policy questions that go beyond the agenda of any one regulator.
- Conflict of interest: owner of many finance companies.

# HLCC

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- Co-ordination between regulators.
- Members:
  - Governor, RBI
  - Chairman, SEBI
  - Chairman, IRDA
  - Finance Secretary, MoF
- Member secretary: Joint Secretary, capital markets, at MoF.

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# Problems with the current regulatory structure

# Difficulties

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- Failure to exploit economies of scale.  
Example: Commodity futures trading could not take off at NSE/BSE.
- Turf conflicts.
- Inhibits products and markets when they involve multiple regulators.

# Conglomerates

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- SBI, ICICI, HDFC: These may be many distinct firms, but they are really one big conglomerate. They are “virtual firms”.
- Conglomerates are given an edge in the current regulatory architecture.
- No one regulator knows the full picture.
- TBTF issues.

# Goals of regulation

# *De facto* “principles of regulation”

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1. Price stability.
2. Protecting the small investor.
3. Preventing market misconduct.

Do these goals lead regulators into the right behaviour?

# Good regulation, good market outcomes

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**The effect of good regulation ought to mean better market outcomes.**

# Example: FSA's principles statement

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1. Using resources in the most efficient way.
2. Be “proportionate” in imposing burden on industry.
3. Facilitate innovation.
4. Think globalisation.
5. Do not impede or distort competition.

# What can architecture reforms achieve?

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- It is important to distinguish problems of architecture from problems of implementation.
- HR problems; process problems: these will remain under any architecture.

# Alternatives

# I. Integrated regulation

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- UK, Japan, Korea, etc. have gone this path.

## II. Rajan & Shah proposal

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- Create a separate regulator for the 10 large conglomerates.
- That separate regulator should have one-stop approval power for all innovations that go beyond one regulator.

# III. Incremental work within present system

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- Take stock of all the regulators, their legal framework,
- Incrementally make improvements, remove decades-old design decisions, clarify mandate.
- This does involve opening up questions about mandate.
- Need better harmonisation of principles of regulation across the various regulators.