ISSN - 2250-1991 | IF : 5.215 | IC Value : 77.65

Research Paper

Economics

Financial Sector Governance – Revisiting The Indian Context

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ABSTRACT

India's financial sector is diversified and rapidly expanding. It comprises banks, insurance companies, NBFC's, pension funds, mutual funds and other smaller financial entities. India has a bank dominated financial sector in which commercial banks account for over 60 per cent of the total assets of the financial system, closely followed by the Insurance. The regulation of the Indian Financial system is carried out by various regulatory agencies, and adequately protected by laws enacted from time to time. Some bodies that help regulate the financial sector in India include; RBI, IRDA, SEBI, PFRDA, and FMC. While the economy bears a secure demeanor with the presence of several financial regulators, what needs pondering is whether they actually bring about a positive combined effect or combat each other. This paper studies the impact of multiple-regulator scenario on the financial climate of India. The solution is in unifying the system for better regulation. The study is limited to the Indian economy and extrapolations made from secondary data.

KEYWORDS financial sector, financial regulation, financial climate, India

Introduction

The financial sector of any country is its backbone, and the success or failure of an economy largely depends on the functioning of this sector. India is a developing economy characterized by a huge and growing population, unbalanced regional development, low and declining currency exchange value, etc. to state a few. The Indian economy can seek to grow to its potential, only in the presence of adequate framework for financial regulation. With finance having much significance within a developing country, it becomes imperative that care is taken to ensure sufficient infrastructural and enforcement machinery in the sector. India has six financial regulatory bodies, viz., Reserve Bank of India, Insurance Regulatory and Development Authority, Securities and Exchange Board of India, Pension Funds Regulatory and Development Authority, and the Forward Markets Commission. While this speaks volumes about security in the financial sector, fingers may be pointed at whether it actually strengthens the sector itself. There is a possibility that such a multitude of regulators with weak interplay amongst themselves, and overlaps in regulatory responsibilities may only confuse and collapse the system.

Methodology

The objective was to learn the role of financial sector functioning and gain an overall understanding of the financial regulators in India, and to check whether the number of regulators had any active role to play in the prosperity/poverty of an economy. These aims do not necessitate collection of primary data, and hence the current study is based only on secondary data from trusted & authentic internet websites, coupled with good quality research papers from reputed and refereed Journals. All financial regulators in India have been studied, so as to gauge their true nature and purpose, and also examine overlaps, if any.

Review of Literature

The study being based on secondary data, calls for detailed reference to published data. A recent study in the area was convinced that multiple regulators in the financial sector could inhibit products and markets, thus weakening the economy (Thomas, Susan & Mohanty, Praveen). They identified a need to harmonise the principles of regulation among various regulators. Another research conducted about a decade ago, vehemently condemned the fragmented structure of regulation in India, as it led to several infirmities in the financial sector development. The study also suggested the setting up of a System Supervisory Authority, which could monitor overlaps, and serve as a single-window clearance mechanism for any innovation that spills between two regulators (Rajan, Raghuram & Shah, Ajay 2005).One study, on financial development in emerging markets, claim that regulatory structures need to be streamlined to avoid regulatory inconsistencies, gaps, overlap, and arbitrage; and this could be achieved by a reduction in the number of regulators, defining their jurisdiction wherever possible in terms of functions. It recommended Regulatory Impact Assessment, to evaluate the costs and benefits of regulatory architecture and implementation, to guard against possible errors of overregulation (Krishnan, K.P., 2011).

Financial regulators in India

It is interesting to note that India is the only developing economy to have as many as five regulators in the financial sector; and is only second to the United States of America (global figures) which has eight financial regulators. While the USA is a developed economy having strong legal infrastructure and enforcement machinery, the existence of several regulators seems justified. In the Indian context however, it is perplexing to think whether (i) such a large number of regulators is essential, and (ii) if so, whether mere regulatory guidelines sans transparency and clarity, can help an economy attain financial affluence.

Roles/Functions/Powers of Financial Regulators in India

Reserve Bank of India: The banking sector has evolved largely over the last two decades. Some of the noteworthy changes relate to increased domestic and foreign competition as against government protection, deregulated interest rates as against administered rates, and greater functional autonomy and operational flexibility as against strict supervision by the RBI. The laws governing banking activity in India are RBI Act, 1934, Banking Regulation Act, 1949, Bankers Books Evidence Act, 1891, Negotiable instruments Act, 1881 to name a few. Being the Central Bank of India, the RBI is entrusted with the function of supervising and regulating the financial system by prescribing broad parameters of banking operations. (Refer Table 1 below)

Insurance Regulatory and Development Authority: The Insurance sector in India, already colossal, and growing at a speedy rate, calls for adequate regulation and governance. Setting up of the IRDA in 1999 on the recommendations of the Malhotra Committee was a landmark decision, to promote competition and financial security in insurance. (Refer Table 1 below)

SEBI: The Securities and Exchange Board of India established in 1992, is the authority which regulates the securities market and protects investors' interests in securities. Priorly, the Indian stock market was seemed unattractive for investment by the masses, especially the middle and lower income groups, who took respite in saving with banks, which appeared to be a secure junction for safe-keeping hard earned monies. (Refer Table 1 below)

PFRDA: The 'Pension Fund Regulatory and Development Authority' Act was passed in September 2013, and notified in February 2014. Ever since, it is a regulating body for National Pension Schemes, subscribed by employees of Central and State Governments, and was gradually extended in May 2009 to private institutions/organizations, self-employed professionals and the unorganized sectors. (Refer Table 1 below)

FMC: Established by the Government of India, under the administrative control of Ministry of Finance (Department of Economic Affairs), Forward Markets Commission found its identity as a prime authority in regulating Forward Contracts, and is headquartered in Mumbai. (Refer Table 1 below)

Sl. No.	Roles/Powers/Functions
Reserve Bank of India	
i	Formulating and implementing monetary policy, to maintain price stability and ensure flow of credit to productive areas
ii	Managing FEMA, 1999 to facilitate foreign trade & maintain the forex market
iii	Issuing and exchanging currency, and destroying currency and coins unfit for circulation; thus regulating currency supply
iv	Performing promotional functions in the national interest
v	Performing merchant banking functions for Central and State Governments
vi	Maintaining bank accounts of all scheduled banks
Insurance Regulatory and Development Authority	
i	Issuance, renewal, modification, suspension and cancellation of registration
ii	Protecting policy-holders' interest wrt terms & conditions of contracts
iii	Prescribing code of conduct and training for insurance intermediaries & agents
iv	Promoting efficient conduct of business & of organizations connected therewith
v	Undertaking inspections & investigations of insurers and insurance intermediaries and adjudicating disputes between them
vi	Specifying the form and manner of maintenance of books of accounts
vii	Supervising functioning of Tariff Advisory Committee
Securities and Exchange Board of India	
i	Regulating business in stock exchanges and other securities markets
ii	Registering and regulating work of intermediaries and depositories
iii	Prohibiting fraudulent and unfair practices in securities markets
iv	Promoting investors' education, and training of intermediaries
v	Prohibiting insider trading in securities
vi	Conducting inquiries and inspection of stock exchanges/intermediaries
Pension Fund Regulatory and Development Authority	
i	To provide old age income security by establishing pension funds
ii	To promote and develop the pension sector in India
iii	To regulate the NPS and other pension schemes in India
iv	To protect the interests of subscribers to the schemes of pension funds
v	To ensure orderly growth of the pension market
Forward Markets Commission	
i	To advise the Government on matters of administration of the FCA, 1952.
ii	To keep forward markets under observation and take necessary action therein
iii	To collect and publish information regarding trading conditions of goods
iv	To submit reports to the Government on the working of forward markets
v	To make proposals to better organization & working of forward markets

Table 1: Functions of the financial regulators in India (Source: Respective official websites)

Multi-regulator scenario:
The decade after liberalization is noteworthy for substantial landmark developments in the financial sector. Three of India's financial regulatory bodies, viz., that for Pension, Insurance and Capital Market regulation were set up between 1991 and 2002. While the move was definitely in the right direction, they were visibly inadequate. A financial system can be judged on the extent to which it caters to growth, stability, and inclusion, and the Indian system is deficient on all of those counts. India's financial system is poor, shallow and unfortunately, promoting inequality. It urgently needs reforms.

The financial sector is India is regulated by independent regulators in the area of banking, insurance, capital markets, commodities markets and pension funds. Moreover, the invisible regulation of the Central Government on the financial system plays a crucial role in influencing the role of such independent regulators. Needed now, is stability in policies, so that inflation levels are maintained low, while liquidity is not endangered. The current scenario witnesses considerable allocation of work between the regulators, leaving significant gaps, agency function overlaps, and adequate scope for regulatory capture[1]. Financial Sector growth rapidity is largely dependent on its systemic depth. This prompts us to ponder over the alternatives we have so as to better the financial system in India.

Problems faced in the multi-regulator scenario
The financial sector in India is overpopulated with regulators. This structure includes gaps where no regulator is in charge, as in the case of sundry Ponzi schemes, which seek to exist outside the regulatory system. Moreover, overlaps in work allocation and conflicting laws have for long engaged the energy of busy policymakers, and ill-defined allocation of responsibilities has generated regulatory turf battles. Some fears propping up on account of poor regulation in the financial market may be;

Inhibitions to financial innovation as a result of micro regulation
Rising transaction costs due to excessive structural regulation
Increasing depositor risk due to inadequate prudential regulation[2]

Results - Examining the alternative:
After a peek into the current scenario of financial regulation in India, one must admit that the financial sector needs immediate overhauling. While regulators may be strengthened so as to identify and allay systemic risks, the measure requires a dedicated team for careful monitoring and formal coordination with multi lateral agencies. This may not be a feasible solution to adopt in the Indian Financial Market presently; as the infrastructures in technological and institutional

Regulatory capture is a process by which regulatory agencies eventually come to be dominated by the very industries they were charged with regulating, and act in the benefit of the industry rather than in public interest.

The prudential regulation is regulation of deposit-taking institutions and supervision of the conduct of these institutions and set down requirements that limit their risk-taking. The aim of prudential regulation is to ensure the safety of depositors' funds and keep the stability of the financial system

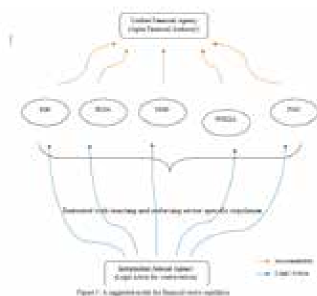
fronts are outdated enough to render our financial systems highly inefficient. The next best alternative that may work wonders is Unification of Financial Authority.

Unified Financial Authority (UFA)
There is much hope in brainstorming for a unified authority in the financial sector, which seeks to regulate, while ensuring consumer/investor protection through safe-guarding against financial fraud. This would benefit in terms of economies of scale and it would reduce the need for identification of a reg-

ulatory agency within a particular sector. Financial prosperity can be achieved only in an environment where the laws are compatible for change and transition. Most existing laws are outdated, enacted at a time when India was a controlled economy. Today, financial markets need to be regulated and supervised by sophisticated interventions. Also, most laws were designed to solve a small set of problems, and sometimes were inconsistent with each other. Thus the current quintessential is having a single financial authority, coupled with compatible legislative framework.

The Model

1 The financial sector regulatory architecture must be modified to involve the following;
2 A single unified financial authority that may have all other regulators under its ambit; and empowered to seek accountability from each of them. Such regulators may be permitted to enact regulations and enforce them, but not awarding penalties (judicial action) for contravention.
3 A Financial Code of conduct, which is a single consistent law with several sections and sub-sections; which can seek to replace all existing outdated and incoherent financial law.
4 An Independent Judicial wing which will hear litigations and pronounce verdicts on actions of other financial regulators



Entrusted with enacting and enforcing sector-specific regulation

Prerequisites for model functioning

- For effective and sustained working of the above model, the following are absolutely essential;
- Suitable systems for accounting, auditing, tax, law and justice delivery
- sound, smart and sustainable policies for the macroeconomic environment
- adequate consumer protection through appropriate mechanisms;
- well-developed and competent financial markets; and
- Increased financial literacy among consumers

5 Conclusion

After having a reasonably long stretch with a deep dose of regulation, which led to the crippling of market mechanism, the need for deregulation and more so, apt regulation will be widely appreciated. But it will bring to limelight new problems and challenges. The experience of financial agency amalgamations will necessitate serious consideration of a shift in regulatory paradigm. The floor will now be open for a fresh wave of what may be termed re-regulation.

What is noticed is a series of regulation, de-regulation and re-regulation yet again! Indeed, this only reveals a metamorphic change in the financial regulatory system. Today the much debated topic that seems to be going around is regards the suitability of various alternative regulatory models. The financial sector and its necessary infrastructure evolve over a pretty long period. Most features of the financial regulatory system that we observe around us today are the result of constant conflicts of interest and opinion. The new found regulatory architecture and infrastructure will open doors to financial progress and prosperity, without compromising consumer interest.

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