# Report Summary

## The Financial Sector Legislative Reforms Commission

- The Financial Sector Legislative Reforms Commission (FSLRC), constituted by the Ministry of Finance in March 2011, was asked to comprehensively review and redraw the legislations governing India's financial system. According to the FSLRC, the current regulatory architecture is fragmented and is fraught with regulatory gaps, overlaps, inconsistencies and arbitrage. To address this, the FSLRC submitted its report to the Ministry of Finance on March 22, 2013, containing an analysis of the current regulatory architecture and a draft Indian Financial Code to replace the bulk of the existing financial laws.

**The Draft Indian Financial Code**

- The draft Code is a non-sectoral, principles-based law bringing together laws governing different sectors of the financial system. It addresses nine components, which the FSLRC believes any financial legal framework should address:

- *Consumer protection*: Regulators should ensure that financial firms are doing enough for consumer protection. The draft Code establishes certain basic rights for all financial consumers and creates a single unified Financial Redressal Agency (FRA) to serve any aggrieved consumer across sectors. In addition, the FSLRC considers competition an important aspect of consumer protection and envisages a detailed mechanism for cooperation between regulators and the Competition Commission.

- *Micro-prudential regulation:* Regulators should monitor and reduce the failure probability of a financial firm. The draft Code specifies five powers for micro-prudential regulation: regulation of entry, regulation of risk-taking, regulation of loss absorption, regulation of governance and management, and monitoring/supervision.

- *Resolution:* In cases of financial failure, firms should be swiftly and sufficiently wound up with the interests of small customers. A unified resolution corporation, dealing with various financial firms, should be created to intervene when a firm is close to failure. The resolution corporation would charge a fee to all firms based on the probability of failure.

- *Capital controls:* While the FSLRC does not hold a view on the sequencing and timing of capital account liberalisation, any capital controls should be implemented on sound footing with regards to public administration and law. The FSLRC sees the Ministry of Finance creating the 'rules' for inbound capital flows and the RBI creating the 'regulations' for outbound capital flows. All capital controls would be implemented by the RBI.

- *Systemic risk:* Regulators should undertake interventions to reduce the systemic risk for the entire financial system. The FSLRC envisages establishing the Financial Stability and Development Council (FSDC) as a statutory agency taking a leadership role in minimizing systemic risk.

- *Development and redistribution:* Developing market infrastructure and process would be the responsibility of the regulator while redistribution policies would be under the purview of the Ministry of Finance.

- *Monetary policy:* The law should establish accountability mechanisms for monetary policy. The Ministry of Finance would define a quantitative target that can be monitored while the RBI will be empowered with various tools to pursue this target. An executive Monetary Policy Committee (MPC) would be established to decide on how to exercise the RBI's powers.

- *Public debt management:* The draft Code establishes a specialised framework for public debt management with a strategy for long run low-cost financing. The FSLRC proposes a single agency to manage government debt.

- *Contracts, trading and market abuse:* The draft Code establishes the legal foundations for contracts, property and securities markets.

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**Regulators**

- With respect to regulators, the FSLRC stresses the need for both independence and accountability. The draft Code adopts ownership neutrality whereby the regulatory and supervisory treatment of a financial firm is the same whether it is a private or public company. The draft Code seeks to move away from the current sector-wise regulation to a system where the RBI regulates the banking and payments system and a Unified Financial Agency subsumes existing regulators like SEBI, IRDA, PFRDA and FMC, to regulate the rest of the financial markets.
- Regulators will have an empowered board with a precise selection-cum-search process for appointment of members. The members of a regulatory board can be divided into four categories: the chairperson, executive members, non-executive members and Government nominees. In addition, there is a general framework for establishing advisory councils to support the board. All regulatory agencies will be funded completely by fees charged to the financial system. Finally, the FSLRC envisages a unified Financial Sector Appellate Tribunal (FSAT), subsuming the existing Securities Appellate Tribunal (SAT), to hear all appeals in finance. Table 1 provides an outline of the FSLRC's proposed regulatory architecture.

**Table 1: FSLRC's regulatory architecture**

| Present | Proposed | Functions |
|---|---|---|
| RBI | RBI | Monetary policy; regulation and supervision of banks; regulation and supervision of payments system. |
| SEBI<br>FMC<br>IRDA<br>PFRDA | United financial agency (UFA) | Regulation and supervision of all non-bank and payments related markets. |
| Securities Appellate Tribunal (SAT) | FSAT | Hear appeals against RBI, the UFA and FRA. |
| Deposit Insurance and Credit Guarantee Corporation (DICGC) | Resolution Corporation | Resolution work across the entire financial system. |
| Financial Stability Development Council (FSDC) | FSDC | Statutory agency for systemic risk and development. |
| New entities | Debt Management Agency | An independent debt management agency. |
| | Financial Redressal Agency (FRA) | Consumer complaints. |

Source: FSLRC Report; PRS.