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P. CHIDAMBARAM'S SPEECH AT ICSI SEMINAR ON INDIAN FINANCIAL CODE

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The Union Finance Minister P. Chidambaram has said that multiplicity of Institutions and multiplicity of Regulators which have come up from time to time to meet newly perceived requirements, has potentially created regulatory overlaps, gaps and ambiguity on account of lack of role clarity. This creates inefficiencies in addressing critical emerging issues in a increasingly dynamic, complex and interconnected financial world. The Minister was speaking at the Institute of Company Secretaries of India (ICSI) National Seminar of Indian Financial Code in New Delhi today. Following is the text of his speech:

"I am happy to be at this National Seminar, first of its kind in Delhi organised by the Institute of Company Secretaries of India and speak in public for the first time on the report of the Financial Sector Legislative Reforms Commission. As you are aware the report was submitted to the Government of India by Mr. Justice Shri Krishna and his committee on the 22nd of March 2013 . I am deeply grateful to the Chairman and the members of the committee. I take this opportunity to offer them my sincere thanks for the remarkable work they have done in completing this demanding task in a competent, expeditious and time bound manner.

The Indian financial sector is governed by around sixty Acts and related rules & regulations. Many of these date back to around 80 years. Long before anybody in this room was born. For e.g. the RBI Act dates back to 1934. The Insurance Act is of 1938 vintage. The securities Contracts Regulation Act was enacted in 1956. Even though large number of amendments have been made to these acts and regulations at different points of time to address emerging needs emanating from a fast changing environment. Necessarily these changes have been piecemeal changes, consequently financial sector statutory framework is fragmented and disparate and does not comprise a streamlined and precise framework adhering to a unified over arching objective or philosophy.

There is also a multiplicity of Institutions and multiplicity of Regulators which have come up from time to time to meet newly perceived requirements . This multiplicity of laws and institution potentially create regulatory overlaps, gaps and ambiguity on account of lack of role clarity. This creates inefficiencies in addressing critical emerging issues in a increasingly dynamic, complex and interconnected financial world.

When we constituted this Commission, the philosophy was that the Commission is to be vested with a task of enquiring the suitability and adequacy of the existing systems and structure rather than to pass judgement . There was a realization that the statutory and institutional foundation of the financial sector in India needs to be looked at afresh to assess its soundness in addressing the emerging requirements in the rapidly changing world. The endeavour is to envisage a sound strategy and institutional structure for the Indian Financial System, while identifying and addressing the complexities, ambiguities, overlaps and gaps arising from the current regulatory framework.

I am glad that the Commission adhered to this philosophy rather than pass judgement it is present to report which provides the basis to build a set of laws and institutions for the future. Mr. Krishanan has shared with you the key recommendations of the Commission.

The Commission has recognised the present financial architecture of India has evolved over the years, the sequence of peace meal decisions and peace meal legislations responding to immediate pressure from time to time. It was not specifically or comprehensively designed to meet some key objectives.

The present arrangement have a number of gap areas where no regulators are unambiguously in charge such as issue of regulatory oversight over diverse ponzi schemes that we have discovered recently. These are cleverly designed to be out of the purview of the existing agencies. The existing framework also contains overlaps between laws and agencies leading to incidences in which conflicts have consumed the energy of the policy makers.

And that an approach of multiple sector regulators that construct silos induces economic inefficiencies. The commission has therefore given wide ranging recommendations to restructure the Financial Laws governing the Financial Sector and regulatory system. You are aware by now that there are Nine Key Components of the Legal Framework recommended by The FSLRC.

These are : 1) Consumer protection 2) Micro Prudential Regulation 3) Resolution 4) Systemic Risk 5)Capital Controls 6)Development 7) Monetary Policy 8) Public Debt Management 9)Foundations of Contracts and Property.

What struck me when I read the summary carefully and then when my officers read the report more carefully are the following:

1. First, the Commission has advocated a non-sectoral approach - Current Indian Laws are based on a sectoral approach laws have been organised around sub sectors of the finance like banking securities, insurance or payments. The Commission has recommended shifting to non-sectoral approach. Secondly, the Commission has advocated a principles based approach.

According to the principle based approach, laws will articulate broad principles that generally do not vary with financial and technological innovation and will leave it to the regulators to write subordinate regulations by way of rules and regulations.

These regulations will cover the operational aspects and procedure, while the principles will remain the same. There is of course a very powerful dissent to this view. Thirdly, The commission has recommended the establishment of independent regulators. Fourthly, the Commission has favoured a strategy of ownership neutrality. At present the laws and regulations in India often differentiate between different owners, different ownership structures, different corporate structures of financial firms.

In order to provide a level playing field the Commission favours a strategy of ownership neutrality in the regulatory and supervisory treatment of a financial firm which would be the same regardless of whether it is an Private Indian, Private Foreign, Co-operative or Public Sector. This in view of the commission would lead to a level playing field .

The Commission has also taken trouble of drafting a Law I am not sure how much of this law will go through in the same fashion when it emerges finally from the Parliament. But it is a commendable effort the Commission has given us a 450 section draft of the Indian Financial Code.

This will make the task of writing the Law much easier because very eminent lawyers were associated with drafting of the Law. I must also mention powerful dissenting notes that have been appended to the Commission's report.

Profession Jayant Verma, has expressed concerns about the authorization requirements for financial service providers. He believes that potentially this will become all encompassing and bring even innocuous activities like a classroom lecture under its ambit .

Three members, Mrs. Udeshi, Dr. P J Naik, Mr. Malegham disagree with the allocation of responsibilities on Capital Controls between the Ministry of Finance and the RBI while the responsibility for regulating inward capital flow of capital has been assigned to the Ministry of Finance and outward capital flows to the RBI. These three members want the current primacy of the RBI over the external sector to be retained. Dr. P J Naik also disagrees with the role of the Ministry of Finance which he once served with great distinction. He disagrees for the role envisaged for MOF in the draft code especially the role of FSDC in particular his concern relates to FSDC having excessive powers and responsibilities that can potentially curtail autonomy of regulators . I suppose his fears arises from the fact that the FSDC will be chaired by the Finance Minister.

Dr. Naik also disagrees with the recommendation in the principle based Law and he favours a common Law approach. Shri Malegham disagrees with the regulation of non-banking financial companies, in particular he is opposed to the recommendations for only deposit taking NBFC's should be regulated by the RBI.

I have given you the flavour of the report the recommendations, the dissent what do we do now . Admittedly, drafting an Indian Financial Code will be a major milestone in Indian Financial Sector Reforms, in contrast with previous attempts at decontrol and deregulation, FSLRC requires positive input when acting legislation and constructing structure of Government agencies . This is much harder than economic liberalization that really means decontrol. The essence of FSLRC implementation lies in the creation state capacity commensurate with the sophisticated financial system for a multi trillion dollar economy . In fact a number of financial sector professional in India is woefully inadequate even for the size of the economy that we have today not to speak of the multitrillion economy that we aspire to become in the next couple of decades . We need to handle this challenge of drafting a financial code at three levels, firstly, a legislative challenge of all steps from now to enactment of agreed legislation to a massive capacity building challenge on numerous fronts particularly in the number of financial sector professionals that we train and employ; three handling the complex problem of transition from shifting the present framework to the new framework . The Ministry of Finance will have to embark on concerted efforts to reach the report and the draft code to the public at large and obtain feedback and comments on the report and educate financial sector professionals on the way forward.

This would involve holding seminars and conferences across the country and I would encourage ICSI and other institutions to organize more of these . I will encourage officers of the Ministry of Finance to participate in these Seminars and Conferences . In addition we need to focus on experts and practitioners including financial professionals, lawyers , regulatory staff and perhaps judges . We will need to set up a formal mechanism through which feedback and comments are submitted and consolidated.

Various units of the Ministry of Finance who need to carry out the required inter-departmental and inter-agency consultations on the proposed challenges alongside very careful analysis of every

sentence of the existing laws, and every section of the proposed code will need to be taken up before we agree upon large scale repeals of legislations .

Passing legislation in India is not easy with coalitions and the legitimization of obstruction as a parliamentary tactic nevertheless we cannot give up we are duty bound to the people of this country to put in place a financial regulatory system that will serve us well for the next 50 more years. While we embark on these tasks, there is something that we can do in the interim . Many of the elements of the FSLRC recommended legal processes are not repugnant to the present laws . Therefore, I suggest that the Ministry of Finance and the regulatory agencies may look seriously at operationalising some of these elements at the earliest even within the scope of the present laws for e.g. detailed and structural stakeholders consultations before issue of new regulations that can be done under the present law. A basic cause benefit analysis of regulation that can be done under present laws . However, these would require considerable internal organizational strengthening, capacity building and workflow modification . I hope that in the Ministry of Finance we can start pursuing these goals forthwith .

Ladies and gentlemen , I see a very rich and detailed programme for the rest of the day. I am sure there will be a lively discussion on the pros and cons of the recommendation in the deliberations in the schedule . I wish the deliberation success and once again would like to compliment Shri Ananthasubramanian , Shri Vaid , Shri Sahoo of the ICSI and all others of the ICSI for taking the initiative in organising the National Seminar . I thank both Shri K P Krishnan and Ms. Chitra Ramakrishna for their valuable inputs."

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