

**Speech of Shri P. Chidambaram, Hon'ble Union Finance Minister at ICSI Seminar
on Indian Financial Code recommended by Financial Sector Legislative Reforms**

Commission on September 30, 2013 at Taj Coromandel, Chennai

Mr. Justice Srikrishna, Chairman of the Committee that drafted the Report, Mr. S. N. Ananthasubramanian, President, Institute of Company Secretaries of India, Ms. Chitra Ramakrishna, Mr. M. S. Sahoo, Members of the Institute of Company Secretaries of India, other speakers of the technical sessions later today, distinguished guests, ladies and gentlemen.

This seminar, the second that I attend and fifth in the series, is on the recommendations of the draft law contained in the FSLRC report. Let me begin by thanking, on behalf of the Government of India, Mr. Justice Srikrishna, who chaired the Committee and who produced this outstanding Report that will guide the Government in many years to come.

This seminar is on the recommendations in the draft law, but I plan to use the opportunity to speak on financial sector reforms on a broader canvass. The FSLRC Report is also all encompassing. As such the themes for discussions today, I hope, will get converged to a great extent.

The last six months have witnessed five institutional milestones in the area of Indian corporate financial institutions. In chronological order, they are: One – the Report of the FSLRC; Two - the New Companies Act; Three - the passage of the PFRDA Bill; Four - placing Commodity Futures Markets Regulation under the Ministry of Finance; and Five - Repromulgation of Securities Laws (Amendment) Ordinance, in the hope that Bill will be passed in next session. When fully operationalized, these will have profound implications for the Indian financial sector. While the Companies Act would impact

beyond the financial sector, all other developments that I listed are directly related to financial sector regulatory and institutional changes.

I have heard some people say that financial sector gets disproportionate policy attention. In the Ministry of Finance, we believe, it gets less than proportionate policy attention. And, we believe that the political discourse in this country also pays less than the deserved policy attention to financial sector.

Efforts of legislative and institutional reforms are undertaken in the financial sector more regularly than in many other areas. The five milestones which I just stated happened during a time frame of six months. But, some of these proposals, let me remind you, have been in the pipe line for many years. It has taken us ten years to enact the PFRDA Act. It has taken thirteen years to accept that the commodity futures market should be a part of organised financial trading. It has taken us two decades to get a new modern Companies Act. It will take some time, I think, some years, before we can implement the recommendations of the FSLRC Report.

So, despite the feeling of the regular reforms in the financial sector, things are happening at the slower than the desired speed. However, it is reassuring to note that there is widespread political support for the financial sector reforms as witnessed by the discussion and passage of the Companies Bill, the PFRDA Bill, the absence of any demur in placing the commodities market under the Ministry of Finance and the hope that the securities law amendment ordinance will become a bill in December.

Why do I say that we need to speed up the second wave of reforms? Financial markets and information technology are two major drivers of change in the today's world. When they combine, the result is high speed and dynamism. That is what the financial market is doing by embracing modern technology in providing financial services. Therefore,

whether we like it or not, the financial sector today operates at the speed of light. Fungible capital travels across the world in nano seconds.

The globalised financial market is an off repeated theme for more than a decade now. This got pronounced after the global financial crisis, when people all over the world witnessed power of globalised finance. It was evident from this that some of the effect of financial globalisation will be negative. And the extent of negative effects varies from country to country depending upon their stage and pace of growth, structure of their economies, degree of integration with the rest of the world and the depth of the financial system. This would call for having an appropriate and solid institutional structures for managing the domestic market and integration of the global system. We cannot fortify our economy against the financial winds from across the shores by turning away from globalisation.

Given the speed and dynamism with which financial sector operates, it generates new space, sometimes undefined areas, which provide opportunities for “unregulated” players in the market. The existence of such players who operate in the twilight zone endanger the discipline of the markets, leading to systemic instability. Invariably, such activities adversely impact a large number of consumers. This reduces their confidence in the system. When, large number of investors, particularly smaller investors, stay away from the system, it reduces the supply of blood to the body economic.

A financial consumer is comfortable to participate in a regulated market. There should be an assurance that she would be protected if she gets into problems. However, exploiting the limitations of the regulatory architecture, financial engineers come up with innovative products outside the regulatory jurisdiction and deprive the consumers of such products of regulatory protection. We believe that we must move quickly to

remove all unregulated space. A recent attempt in this direction is the Ordinance, that I referred to, which was first promulgated on July 18 this year and repromulgated on September 16, which considers any raising of resources by whatever means, if not regulated otherwise, as a collective investment scheme. Our endeavour is to eliminate unregulated space.

My government is focused on protection of financial consumers. The new company law has many explicit measures to protect them. I do not wish to dwell on the many provisions of the new Companies Act.

Where are we now? It is not that India has not implemented many of the needed reforms in the past. Many good things have been done in Indian Finance. We have travelled at a reasonable speed in financial sector reforms since the early 90s. But as I said a little while earlier, the speed is not good enough as financial developments unfold thick and fast. Moreover, we have been responding to events rather than anticipating them. The move of the financial of the commodities futures market to the Ministry of Finance is a response to a crisis and did not anticipate the crisis.

In the changing world, financial economic policy has to catch up with the needs of future India that we are aspiring to build. Generally, our policy process involved developing new ideas and a consensus around them through a sequence of expert committees. The four milestones in this journey in the last decade were the Committee chaired by Mr. Percy Mistry on International Finance, Dr. Raghuram Rajan on Domestic Finance, Mr. U K. Sinha on Capital Controls, and Mr. D. Swarup on Consumer Protection. From 2007 to 2011, there was considerable debate about these questions. A consensus emerged on the board strategy that we should take. Then for effecting an overarching institutional

change, we set up the FSLRC - a Legislative Reforms Commission- that is the Report before you today.

The last two decades also witnessed many new legislative initiatives - the SEBI Act, the Depositories Act, the IRDA Act and various amendments to these and other financial sector laws etc. We also created new organisations – SEBI, IRDA, the interim PFRDA- now the PFRDA, new Exchanges, Depositories, Clearing and Settlement Systems, Payment Systems, etc. These organisations and these laws refined and extended reforms at ground level, some of them, in an exemplary manner.

Consequently, our existing markets has achieved considerable dynamism and earned global repute. Many more people got included in financial systems, particularly in banking and insurance. More recently, new pension schemes have started fanning out to reach larger and larger number of people in unorganised sector.

Now, how do we achieve next wave of changes? The next wave of reforms will be through strengthening our institutional foundation- both laws and organisations; improving and polishing our processes; and by taking well designed policy decisions which will enhance clarity, consistency and transparency for a globalised India.

The FSLRC recommendations and the draft law that the Commission has prepared would go a long way in achieving many of the objectives, particularly in the area of institutions and processes. It is my intention that we adopt the basic spirit of the framework provided by the FSLRC in building a strong institutional foundation for our financial sector. I do not wish to dwell at great length on all the recommendations of FSLRC in detail. This has been done and will be referred to in greater details in the technical sessions. Justice Srikrishna himself has referred to many of them. Let me just flag the main issues.

As all of you are aware by now that there are nine key components of the legal framework recommended by the Commission. These are: 1) Consumer protection and competition; 2) Micro Prudential Regulation; 3) Resolution; 4) Systemic Risk; 5) Capital Controls; 6) Development; 7) Monetary Policy; 8) Public Debt Management; and 9) Foundations of Contracts and Property.

What struck me when I read the summary carefully are the following: Firstly, the Commission has advocated a non-sectoral approach. This is in complete contrast to current laws which are based on sectoral approach. Secondly, the Commission has advocated a principles based approach. Drafting a new law on principles based approach will be a novel experiment in India. Thirdly, the commission has recommended the establishment of independent regulators. Fourthly, the Commission has favoured a strategy of ownership neutrality.

The Commission has taken the trouble to draft the law. I am not sure how much of this law will eventually go through the process of law making and finally emerge in the manner recognised by the Members of the Commission. But, I sincerely hope that the commendable effort made by the Commission, including 450 sections draft of the Indian Financial Code, can be enacted substantially in the same manner as the drafts presented to us. There are, of course, powerful dissenting notes, that in the interest of transparency, the Commission has appended to the Report. And I am sure, that while we make law, we will take note of the powerful dissents that have been appended.

In conclusion, May I say this? What we are undertaking is indeed an ambitious task. Institutional revamping, making a new law based on principles, establishing the processes are not for the weak hearted, the suggestions made by the Commission have the potential to change the manner in which we regulate India's financial system.

We have delivered path breaking institutional reforms in the past. There is no reason to think that we cannot deliver path breaking financial sector reforms now. We must do this to plug the limitations in our existing structures and to achieve our growth potential in full.

In the Government of India, we have already initiated steps, to improve the regulatory governance process and we have also initiated discussion on the non-legislative steps recommended by the FSLRC. The legislative parts will be pursued after due consultations. We will set up various project management groups for charting, synchronising and sequencing the actions required in implementing big institutional changes.

Ladies and gentlemen, I can only assure you that the financial sector policy will be in tune with our aspirations for India and will promote clarity, consistency, competition and transparency and protect the autonomy of the institutions. It will be difficult for me to spell out details of the policy at this stage, because policies are taken based on emerging requirements. However, we recognise the need to redraw the institutional structures and processes as quickly as possible.

Spreading awareness on these complex issues and eliciting public comments is a first step which seminars like this intend to achieve. It is an important step in formulating informed policies. I commend the initiative of the ICSI in organising a number of such events in different parts of India. I take this opportunity to wish all of you success in your deliberations at the three technical sessions and I look forward to outcome of the deliberations.

Thank you.