Financial regulations in India: what do we learn?

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Regulators: RBI, FMC, CCI.

The early 1990s

Equity market reforms:
- Establishment of SEBI.
- Establishment of NSE, NSDL up to 2001 and the start of derivatives trading
- A new concept of ownership and governance of exchanges: “three way separation”.
  - BSE shifted to a new model of ownership and governance.
- NSE and BSE are in the top 5 exchanges of the world by number of trades.

Next: IRDA, PFRDA
Two case studies

- Where regulation worked: The Indian Mutual Fund Industry
- Where regulation killed an industry: The Indian Micro Finance Industry
Key concepts

All activities of the government in finance are rooted in:

1. Consumer protection.
4. Resolution.

Interventions must be motivated by this economic purpose.
Example 1: the Mutual Fund industry reforms

- Regulatory action: improve disclosure
- Empower customers of the MF products.
- Outcome: A very stable and robust MF industry.
Example 2: the Micro-finance institutions reforms

- Trigger: reports of multiple suicides amongst borrowers, September 2010.
- The crisis arose as a problem of *consumer protection.* Solving this requires tools of consumer protection: laws, disclosures, redressal mechanisms.
- Outcome: A large fraction of MFIs have shut down; the only left standing are the large ones that were accused during the crisis.

Our work here (see http://www.igidr.ac.in/FSRR/papers.html)
Example 3: SEBI AIF regulation

- Private equity fund or hedge fund or venture capital fund
- No problem with consumer protection.
- No problem with micro-prudential regulation.
- A potential problem with systemic risk.
  Put in place resolution and micro-prudential regulation when AUM exceeds 1% of GDP.
Why do Indian financial regulators behave as they do?
The checks and balances are written in the law.
How to make progress?
A bold step: Rewrite the law.
Financial Sector Legislative Reforms Commission
Chaired by Justice Srikrishna
Has released an approach paper: http://goo.gl/Vd7HX
Key insights

- Sound foundations of independance and accountability for regulators.
- Sectoral regulators are a bad idea:
  - Tends to adopt the worldview of the industry
  - Tends to see this as turf
  - Meddling / central planning / similar notions
- Much better to have one regulatory agency that has clear economic purpose.
Insights for global regulation?

- Regulations and rules have power when they are backed by law.
- No discussions about global market regulations focus centrally on this. Dealing with laws are left to participants as part of implementation details.
- This approach misses the accountability of regulation; throws their independance into question.
- Needs to be solved to truly empower global regulation.
Thank you.
http://www.igidr.ac.in/FSRR