



**भारतीय रिज़र्व बैंक**  
RESERVE BANK OF INDIA

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## India: Financial System Stability Assessment

Consequent upon the IMF Board decision adopted on September 21, 2010 it was decided to include 25 systemically important economies, including India, under the Financial Stability Assessment Programme (FSAP) for members with systemically important financial sectors. The joint IMF-World Bank Financial Stability Assessment Programme (FSAP) was conducted for India. [IMF has now released their report](#) on the Financial Sector Stability Assessment for India. The Reserve Bank of India (RBI), the Securities and Exchange Board of India (SEBI) and the Insurance Regulatory and Development Authority (IRDA) welcome the comprehensive review of the Indian financial system by the joint IMF-World Bank team. The Indian financial system has been assessed in relation to the highest international standards.

2. The assessment recognises that the Indian financial system remained largely stable on account of a sound regulatory and supervisory regime. However, the assessment identifies some gaps, including in international and domestic supervisory information sharing and co-operation, consolidated supervision of financial conglomerates, and some limits on the *de jure* independence of the regulators (RBI and IRDA).

3. RBI, recognising their importance, has made efforts to establish information sharing mechanisms with various jurisdictions in which Indian banks are operating. RBI has so far entered into information-sharing MoUs with 12 jurisdictions. An additional 2 MoUs are scheduled to be signed shortly. Furthermore, RBI has carried out overseas inspections of Indian bank branches in the UK, the USA, Bahrain, Hong Kong and Singapore covering around 60 per cent of their total assets overseas. Efforts are also underway to establish supervisory colleges. The IRDA is also addressing issues relating to sharing of information at the international level through entering into a Multilateral Memorandum of Understanding (MMoU) under the aegis of the International Association of Insurance Supervisors (IAIS).

4. With regard to the issue of large exposure limits, it is true that the group borrower limit is higher than international norms. Some of the major corporate groups are key drivers of growth of the Indian economy. Keeping the group borrower limit at the level of the single borrower limit would severely constrain the availability of bank finance, which would hamper the growth of the economy.

5. RBI recognises that there could be moral hazard issues posed by the appointment of an RBI officer as a nominee director on the banks' board. However, this system has served India well and ensured more effective compliance with RBI regulations from the banks' side. Nevertheless, RBI is sensitive to the issue and has taken up the matter with Government of India for amendment of the enabling legal provisions.

6. As regards Statutory Liquidity Ratio (SLR) hampering monetary transmission mechanism, it is observed that the SLR holding of banks has been brought down over time. As government market borrowings are at market-determined interest rates, monetary policy transmission is not impeded by SLR holdings. The holding of government bonds could help banks to better cope with financial stress situations by giving greater access to liquidity. While the Financial System Stability Assessment (FSSA) recognises the benefit of Cash Reserve Ratio (CRR)/SLR in providing liquidity to banks in crisis time, the financial stability enhancing role played by them is also important. Nevertheless, steps are underway to enhance liquidity in government securities market.

7. With respect to securities markets regulation, SEBI has clear regulatory framework for all market segments and products, including the structure and operations of collective investment schemes. SEBI has taken several steps to re-energise mutual fund industry to increase product penetration especially in smaller cities/towns: regulation of distributors, advisors, and issues concerning investor protection; develop a long-term policy; and increase household savings through mutual funds.

8. As regards better auditing and accounting standards in the securities market, the Companies Act and Chartered Accountants Act provide a framework to maintain objectivity and integrity of accounting and audit. The Government of India has set up Quality Review Board (QRB) for reviewing the quality of auditors. The Companies Bill 2012 as passed by Lok Sabha contains provisions for establishment of an independent quasi-judicial agency, the National Financial Reporting Authority, to oversee the functions of Auditors and to ensure scrutiny and compliance with accounting and auditing standards. SEBI has set up a Forensic Accounting Cell on February 7, 2012 to improve quality of financial information disclosed and to assist in detection of financial irregularities. To enhance the quality of financial reporting done by listed entities, SEBI has set up a Qualified Audit Report Review Committee (QARC) on which ICAI, Stock Exchanges and others are represented.

9. As far as recommendation of the assessor to establish independent risk committees in Central Counter Parties (CCPs) is concerned, SEBI has already decided in April 2012, while reviewing the ownership and governance of Market Infrastructure Institutions (MIIs), that CCPs will constitute a risk committee comprising independent members which shall report to the Board of the CCP as well as directly to SEBI on issues and matters so identified and prescribed.

10. With regard to strengthening the supervision of intermediaries, the level of enforcement action taken by SEBI is very high. SEBI has used warnings and letters of deficiency to address findings from inspection reports, although in a few cases 'harder' measures, such as disgorgement and payment of money under adjudication or consent proceedings, have been imposed. Theme-based inspections have been carried out by SEBI in respect of market intermediaries, mutual funds, depositories, stock exchanges, etc.

11. Under the framework of recently constituted inter-regulatory Early Warning Group (EWG) for financial markets under the Financial Stability and Development Council (FSDC) Sub-Committee, SEBI has constituted an Early Warning Team which monitors and takes steps to address various potential crisis scenarios as per the crisis prevention and management plan of SEBI.

12. SEBI has laid down a two-tier supervision system for mutual funds. At the first level the trustees of mutual funds supervise the day-to-day operations of mutual funds. Further, the mutual funds are required to periodically report on their operations/activities to SEBI. A risk-based approach is followed in this regard.

13. With respect to regulation of the insurance industry, IRDA is of the view that there is complete oversight over the Life Insurance Corporation of India (LIC) with regard to both market conduct and prudential regulations. While Indian Third Party Motor Pool has been dismantled in the year 2012, in its place the framework for Motor Third Party Declined Risk Insurance Pool has been put in place. The issues relating to inadequacy of reserves have also been addressed through directions issued to increase the premium in this segment. The enforcement powers are being strengthened in the proposed Insurance Laws (Amendment) Bill. IRDA is working towards a comprehensive fraud monitoring policy for both life and non-life insurance companies. Further, the IRDA is also examining various issues relating to moving towards the risk-based approach to solvency.

14. With regard to the information sharing and co-ordination among domestic regulatory authorities, it may be noted that the FSDC, under the chairmanship of Finance Minister, provides for effective regulatory co-ordination.

15. With regard to the *de jure* autonomy of regulatory bodies, it merits consideration that financial sector regulators in India operate within statutory frameworks that prudently balance the role of Government in policy making with autonomy and independence for regulatory bodies to transparently perform regulatory functions through exercise of statutory powers. The *de facto* position too reveals no interference in the functioning of regulators. Steps are underway to accord a statutory basis to the pensions regulator also. To streamline and further strengthen the statutory framework, comprising an array of statutes enacted since 1930s and address regulatory overlaps, the Financial Sector Legislative Reforms Commission (FSLRC) has been set up by Government, which is expected to give its report by March 2013.

16. Despite having reservations on a few issues, overall the Indian authorities expect the FSAP exercise to play a significant role in shaping our post-crisis initiatives to strengthen the regulatory and supervisory architecture based on the evolving international consensus as well as careful examination of their relevance in the India-specific context. As a member of the FSB, BCBS and IMF, India is actively participating in post-crisis reforms of the international regulatory and supervisory framework under the aegis of the G20. India remains committed to adoption of international standards and best practices, in a phased manner and calibrated to local conditions, wherever necessary, as it is a country characterised by complex and diverse socio-political and economic conditions.