AIJRRLSJM VOLUME 1, ISSUE 5 (2016, JUNE) (ISSN-2455-6602) ONLINE
ANVESHANA'S INTERNATIONAL JOURNAL OF RESEARCH IN REGIONAL STUDIES, LAW, SOCIAL SCIENCES, JOURNALISM AND MANAGEMENT PRACTICES

A STUDY ON GOVERNMENT REGULATIONS AND REFORMS FOR FINANCIAL SECTOR OF INDIA

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ABSTRACT:

Budgetary area changes have for some time been viewed as an imperative piece of the motivation for approach change in creating nations. Generally, this was on the grounds that they were required to build the proficiency of asset preparation and designation in the genuine economy which thusly was relied upon to create higher rates of development. Change of the monetary division was recognized, from the very beginning, as an indispensable piece of the financial changes started in 1991. As right on time as August 1991, the administration designated an abnormal state Committee on the Financial System (the Narasimham Committee) to investigate all parts of the budgetary framework and make complete recommendations for changes. The paper uncovers the real pretended by the administration in controlling the money related area of India.

INTRODUCTION

India's financial sector is diversified and expanding rapidly. It comprises commercial banks, insurance companies, non-banking financial companies, cooperatives, pension's funds, mutual funds and other smaller financial entities. Ours is a bank dominated financial sector and commercial banks account for over 60 per cent of the total assets of the financial system followed by the Insurance. Other bank intermediaries include regional rural banks and cooperative banks that target under serviced rural and urban populations. Many non banking finance companies (NBFC) operate in specialized segments (leasing, factoring, micro finance, infrastructure finance), though some can accept deposits. Pension provision covers 12 percent of the working population and consists of civil service arrangements, a compulsory scheme for formal private sector employees, and private scheme offered through insurance companies.

CURRENT REGULATORS OF THE FINANCIAL SYSTEM

The control and supervision of the budgetary framework in India is completed by various administrative specialists. The Reserve Bank of India (RBI) controls and directs the real piece of the monetary framework. The supervisory part of the RBI covers business banks, urban agreeable banks (UCBs), some money related foundations and non-saving money back organizations (NBFCs). A portion of the money related organizations, thus, manage or oversee different establishments in the monetary area, for example, Regional Rural Banks and the Co-agent banks are administered by National Bank for Agriculture and Rural Development (NABARD); and lodging fund organizations by National Housing Bank(NHB). Branch of Company Affairs (DCA), Government of India directs store taking exercises of corporate, other than NBFCS. Enrolled under organizations Act, however not those which are under partitioned statutes. The Registrar of Cooperatives of various states on account of single state cooperatives and the Central Government on account of multi-state cooperatives are joint controllers, with the RBI for UCBs, and with NABARD for rustic cooperatives. Though RBI and NABARD are worried about the keeping money elements of the cooperatives, administration control rests with the State/Central Government. This „dual control" impacts the supervision and direction of the helpful banks. The capital market, common assets, and other capital market middle people are managed by Securities and Exchange Board of India (SEBI), Insurance Regulatory and Development Authority (IRDA) controls the protection area; and the Pension Funds Regulatory and Development Authority (PFRDA) directs the benefits reserves.

SALIENT FEATURES OF THE PRESENT REGULATIONS

At present, money related control in India is situated towards item direction, i.e. every item is independently directed. For instance, settled stores and other managing an account items are directed by the Reserve Bank of India (RBI), little investment funds items by the Government of India (GoI), common assets and value showcases by the Securities and Exchange Board of India (SEBI), protection by the Insurance Regulatory Development Authority of India (IRDA) and the New Pension Scheme (NPS) by the Pension Fund Regulatory and Development Authority (PFRDA). Every one of these controllers have a key order to ensure the premiums of clients - these might be financial specialists, approach holders or benefits support endorsers, contingent upon the item. India has a heritage monetary administrative design. The present work distribution between RBI, SEBI, IRDA, PFRDA, and Forward Market Commission (FMC) – was not composed; it has advanced throughout the years, with a succession of piecemeal choices reacting to prompt weights every once in a while. Every controller have their own standards on enrolment, set of accepted rules, commissions and expenses to screen the item suppliers and merchants. RBI, SEBI and IRDA have grievance change techniques through segment money related Ombudsmen administrations.

Issues with different controllers in India: with various controllers in India, there are shifting administrative prerequisites which regularly prompts administrative arbitrage. A case of this is the likeness between common assets and ULIPs, the primary which is directed by the SEBI and the second which were managed by the IRDA. SEBI forces altogether different levels of divulgence and continuous straightforwardness on the results of shared assets contrasted with the norms of revelation required by the IRDA. In a case on varying gauges of control on merchants, representatives of banks who go under direction by the RBI can circulate budgetary items, for example, shared assets and protection items, without sticking to the principles and control of SEBI and IRDA. The present plan has holes for which no controller is in control –, for example, the various sorts of ponzi plans that occasionally surface in India, which are not managed by any of the current offices. Associations, for example, chit-stores have all the earmarks of being totally out of the domain of any monetary segment controller. The current structure likewise contains covers amongst laws and offices prompting frequencies in which clashes between controllers has devoured the vitality of monetary arrangement creators and kept down market advancement. Securities and Exchange Board of

India's (SEBI) expanded case against the Sahara gathering, and the current examinations on claimed illegal tax avoidance by a few banks utilizing protection items are great cases of both administrative holes and also open doors for arbitrage. Mirroring these challenges, the present Indian money related administrative engineering has, throughout the years, been all around reprimanded.

REGULATORY SYSTEMS PREVALENT IN OTHER COUNTRIES

Based on the lessons from the recent global financial crisis, several changes have been introduced in the regulatory framework across countries. The most radical changes are being contemplated in the United Kingdom. The United Kingdom formerly had a unified regulator, the Financial Services Authority, formed in 1997. The Financial Services Authority has been disbanded and replaced by the Financial Services Act. This Act gives the Bank of England responsibility for financial stability, bringing together macro and micro prudential regulation, creates a new regulatory structure consisting of the Bank of England's Financial Policy Committee, the Prudential Regulation Authority and the Financial Conduct Authority. The Financial Conduct Authority is responsible for regulating and policing the banking system. The Prudential Regulation Authority carries out the prudential regulation of financial firms, including banks, investment banks, building societies and insurance companies.

The United States has a Financial Stability Oversight Council that looks at monitoring risks to the US financial system and being a consultative council to facilitate communication among financial regulators.

In Australia, prudential regulation and conduct regulations had been divided and mandated to two distinct regulatory bodies, the Australian Prudential Regulation Authority (APRA) that governs the adopted in the mid 1990s, withstood the crisis relatively better. Similarly in Canada, Prudential Regulation and Conduct Regulation has been placed in separate agencies financial institutions and the Australian Securities & Investments Commission (ASIC) that governs corporate conduct. This model which was adopted in the mid 1990s, withstood the crisis relatively better. Similarly in Canada, Prudential Regulation and Conduct Regulation has been placed in separate agencies.

FINANCIAL LEGISLATIVE STRUCTURE IN INDIA

The present landscape of financial law is less than satisfactory in certain respects. Today, India has over 60 Acts and multiple rules / regulations that govern the financial sector15. Many laws from the 1950s and the 1960s have an emphasis on banning certain financial activity, rather than on establishing regulatory structure for it16 . The genesis of many of the Acts, rules, regulations that govern the financial sector in India can be traced back more than half a century in some cases. The RBI Act and the Insurance Act were enacted in 1934 and 1938 respectively and the Securities Contracts Regulation Act, which governs securities transactions, was legislated in 1956 when the financial landscape was very different from that seen today. For example, Let's take the banking regulations, they were established before ATMs, credit cards, internet banking, investment advisory services, private banking, selling mutual funds and debt products, direct selling agents, vehicle loans, derivatives and a whole lot of other new products and services existed. These Acts have been amended time and again to keep pace with a changing reality but its legal foundations remained more or less static .The result is a frame work which is at times complex, ambiguous, inconsistent, and occasionally open to regulatory arbitrage.

REFORMS IN THE FINANCIAL SECTOR

Financial sector reform affects everyone in the country and beyond given the growing interface of our economy with the rest of the world. We live in a globalizing world with strong and growing inter-connections between our financial systems. What happens anywhere in the world will have an impact everywhere, as indeed demonstrated by the experience of the last five years. As foreign banks come into our country, and our banks expand their global footprint, we cannot afford to be offline on global standards and international best practices. As the former Managing Director of the IMF has said "just because this crisis originated in advanced economies, emerging economies cannot assume that they have insulated themselves from all future crises. Such hubris can be dangerously costly" 18. Along with financial globalization, complexities of financial regulation have also increased. This became more complex after the crisis and following the adoption of greater scrutiny of the concerns arising from terrorism-related financial activities. The new obligations under the Financial Action Task Force (FATF) and combating the Financing of Terrorism (CFT) regimes have necessitated co-ordination between domestic financial regulators amongst all the jurisdictions and between the global coordinating institutions. Greater co-ordination has also become imperative in the context of concerns on financial stability. All these factors necessitate the need to redraft our legislation and harmonize them with international standards 19. An efficient financial system has been regarded as a necessary pre condition for higher growth. Propelled by this ruling paradigm, several developing countries undertook programmes for reforming their financial system.

FINANCIAL SECTOR REFORMS IN INDIA

The role of the financial system in India, until the early 1990s, was primarily restricted to the function of channelling resources from the surplus to deficit sectors. Whereas the financial system performed this role reasonably well, its operations came to be marked by some serious deficiencies over the years. The banking sector suffered from lack of competition, low capital base, low productivity and high intermediation cost.

After the nationalization of large banks in 1969 and 1980, public ownership dominated the banking sector. The role of technology was minimal and the quality of service was not given adequate importance. Banks also did not follow proper risk management system and the prudential standards were weak. All these resulted in poor asset quality and low profitability. Among non-banking financial intermediaries, development finance institutions (DFIs) operated in an over-protected environment with most of the funding coming from assured sources at concessional terms. In the insurance sector, there was little competition. The mutual fund industry also suffered from lack of competition and was dominated for long by one institution, viz., the Unit Trust of India. Non-banking Financial Companies (NBFCs) grew rapidly, but there was no regulation of their asset side. Financial markets were characterized by control over pricing of financial assets, barriers to entry, high transaction costs and restrictions on movement of funds/participants between the market segments. Apart from inhibiting the development of the markets, this also affected their efficiency. Against this backdrop, wide-ranging financial sector reforms in India were introduced as an integral part of the economic reforms initiated in the early 1990s. Financial sector reforms in India were grounded in the belief that competitive efficiency in the real sectors of the economy will not be realized to its full potential unless the financial sector was reformed as well. Thus, the principal objective of financial sector reforms was to improve the allocative efficiency of resources and accelerate the growth process of the real sector by removing structural deficiencies affecting the performance of financial institutions and financial markets.

The main thrust of reforms in the financial sector was on the creation of efficient and stable financial institutions and markets. Reforms in respect of the banking as well as non-banking financial institutions focused on creating a deregulated environment and enabling free play of market forces while at the same time strengthening the prudential.

Table 1: Financial Development - Select Indicators

Item	1960s	1970s	1980s	1990s	2000s
Private Credit/Total Credit (%)	43.0	58.4	59.0	56.6	64.5
Private Credit/GDP (%)	9.5	18.8	28.7	28.6	43.0
Total credit/GDP (%)	22.2	32.0	48.8	50.6	66.2
M3/GDP (%)	21.2	28.4	40.8	49.9	73.5
M3 Velocity (times)	5.0	3.9	2.7	2.2	1.5
M1 Velocity (times)	7.0	6.7	7.1	6.4	5.4
Market Capitalization/GDP (%)	-	-	8.8	35.8	58.7
Per Capita Real GDP Growth (%)	1.6	0.5	3.2	3.7	5.4
Real GDP Growth (%)	4.0	2.9	5.6	5.8	7.2

Note: Domestic credit to the commercial sector is taken as proxy for private credit.
Source: RBI, Working Paper on Financial Structure and Economic Development in India; An Empirical Evolution by S. Sahoo, February 2013

First, an important indicator of bank-based financial deepening, i.e Private sector credit has expanded rapidly in the past five decades thereby supporting the growth momentum. Second, financial innovations have influenced velocity circulation of money by both reducing the transaction costs and enhancing the liquidity of financial assets. A relatively increasing value of velocity could be seen as a representative indicator of an efficient financial sector. In case of India, the velocity circulation of broad money has fallen since 1970s partly reflecting the fact that, in the midst of crisis, money injected to the system could not get distributed efficiently from the banking system to non-banks. Sharper fall in the velocity of narrow money reflected reluctance among banks as well as the public to part with liquidity. Third, the market-based indicator of financial deepening, i.e., market capitalization-to-GDP ratio has increased very sharply in the past two decades implying for a vibrant capital market in India. Various reform measures undertaken since the early 1990s by the Securities and Exchange Board of India (SEBI) and the Government of India have brought about a significant structural transformation in the Indian capital market. Although the Indian equity market has become modern and transparent, its role in capital formation continues to be limited. Unlike in some advanced economies, the primary equity and debt markets in India have not yet fully developed. The size of the public issue segment has remained small as corporate have tended to prefer the international capital market and the private placement market. The private corporate debt market is active mainly in the form of private placements.

However, the domestic credit provided by the Indian banks still remains at an abysmally low as compared with major emerging market and developing economies (EDEs) and advanced economies (Table 2). Furthermore, the level of credit disbursement is also far below the world average levels. Therefore, there is scope for the Indian banks to expand their business to important productive sectors of the economy.

Table 2: Domestic Credit Provided by Banking Sector

(% of GDP)

Country/ Region	1980	1990	2000	2005	2008	2009	2010	2011
Brazil	43.0	87.6	71.9	74.5	96.9	95.8	95.2	98.3
China	53.3	89.4	119.7	134.3	120.8	145.1	146.3	145.5
Euro area	93.6	97.0	119.4	127.3	142.8	152.6	156.0	153.6
India	37.0	50.0	51.4	58.4	67.7	70.4	73.0	75.1
Japan	185.7	255.3	304.7	317.6	302.4	329.8	329.0	340.9
Russia	-	-	24.9	22.1	23.9	33.7	38.4	39.6
South Africa	76.4	97.8	152.5	178.5	173.8	184.2	182.4	167.0
South Korea	43.4	51.9	74.7	88.3	109.4	109.4	103.1	102.3
UK	36.2	118.2	130.2	161.9	213.5	229.2	222.6	213.8
US	120.2	151.0	198.4	225.4	222.0	234.9	232.9	233.3
World	93.5	130.6	158.9	162.1	154.7	169.1	167.4	165.3

Source: RBI, Working Paper on Financial Structure and Economic Development in India; An Empirical Evolution by S. Sahoo, February 2013

India weathered the disruptions in the global financial system mainly due to a robust regulatory and supervisory framework, limited openness and global exposure of banking system with timely policy actions especially to manage liquidity. It was, however, acknowledged that financial sector reforms has to keep progressing with continued improvements in regulation, supervision and stability areas in order to avoid build up of new vulnerabilities. The global financial crisis provided a renewed impetus to the second generation financial sector reforms in India whose major components could be identified as: (i) adherence to international standards, especially implementing G20 commitments; (ii) developmental measures; and (iii) stability measures 23. Against the backdrop of a felt need that the legal and institutional structure of the Financial sector in India need to be reviewed and recast in tune with the contemporary requirements of the sector, The Financial Sector Legislative Reforms Commission (FSLRC), headed by Justice B.N. Sri krishna, was set up by Ministry of Finance in March 2011 to review, simplify and rewrite the legal and institutional structures of the financial sector.

CONCLUSION:

The reforms currently under way in the banking sector and in the capital market, combined with the agenda for reform identified for the insurance sector, represent a major structural overhaul of the financial system. It will certainly bring India's financial system much closer to what is expected of developing countries as they integrate with the world economy. As in so many other areas, reforms in the financial sector have been of the gradualist variety, with changes being made only after much discussion and over a somewhat longer period than attempted in most other countries. However the direction of change has been steady and in retrospect a great deal has been accomplished in the past seven years. It is essential to continue these reforms along the directions already indicated and to accelerate the pace of change as much as possible. Finally, it is important to recognize that financial sector reforms by themselves cannot guarantee good economic performance. That depends upon a number of other factors, including especially the maintenance of as a favourable rnacro-economic environment and the pursuit of much needed economic reforms in other parts of the real economy. The impact of financial sector reforms in accelerating growth will be maximized if combined with progress in economic reforms in other areas.

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