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FSLRC AND THE CONCEPT OF SUPER REGULATOR

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ABSTRACT

Financial Sector Legislative Reforms Commission (FSLRC) which was constituted by the Government of India, Ministry of Finance, in March, 2011, was mainly set up to review and restructure the legal and institutional structures of the financial sector in India. FSLRC issued its report covering various issues to bring out coherence in the financial regulatory framework of India. Owing to jurisdictional conflicts between regulators in India, there arose need to have a super regulator in India. Thus, in order to analyze whether the concept of super regulator is apt for India, a comparison is made with the financial regulation of the USA and the UK. While the USA, has the concept of multiple regulators, with an authority referred to as "lead regulator" who would supervise the work of the regulators without intervention with the functioning of individual regulators. The UK on the other hand, has the concept of "super regulator". Thus, by comparing with the financial regulation of the USA and the UK, an analysis is made as to which is a viable option for India- Super Regulator or Lead Regulator.

Keywords- FSLRC, Super Regulator, Lead Regulator

INTRODUCTION

Financial Sector Legislative Reforms Commission (FSLRC) was constituted in 2011 with the objective to review and revise the legal and institutional structures of the financial sector in India so as to meet the contemporary requirements of the sector. The FSLRC report was submitted in March 2013. The report was presented in two volumes. The first volume covered the following issues:-

(i) Current norms and the prevailing practices in the Indian Financial Sector
(ii) Gaps and shortcomings
(iii) The ways to overcome these shortcomings.[1]

The second volume proposed one piece of legislation, namely the Indian Financial Code (IFC) which is non-sectoral in nature, in order to overcome the shortcomings in the financial sector of India. The nine components under which amendments were proposed in the IFC includes Consumer Protection, Micro- Prudential Regulation, Resolution, Systematic Risk Regulation, Capital Controls, Monetary Policy, Public Debt Management, Development and redistribution and Contracts, Trading and Market Abuse.[2]

Out of the various recommendations, one of the recommendation made in the FSLRC report was the merger of Securities and Exchange Board of India (SEBI), Forward Markets Commission (FMC), Insurance Regulatory and Development Authority (IRDA) and Pension Fund Regulatory and Development Authority (PFRDA) under the proposed head of Unified Financial Agency (UFA) in order to achieve the objective of implementing consumer protection law. While analyzing the feasibility of having either a super regulator or a lead regulator in India, a comparison of regulatory framework of India with that of the USA and the UK is required. These two countries have been mainly chosen because of the long standing of their regulatory institutions and also India has borrowed a number of regulatory structures and practices from these countries. Also, while the USA has the

[1] Government of India, fslrc_report_vol1_1.pdf, , https://dea.gov.in/sites/default/files/fslrc_report_vol1_1.pdf (last visited Sep 27, 2019).
[2]Government of India, *Id.*fslrc_report_vol2_1.pdf, , https://dea.gov.in/sites/default/files/fslrc_report_vol2_1.pdf (last visited Sep 27, 2019).

concept of lead regulator, the UK follows the concept of super regulator. Thus, this paper attempts to answer:-

(1) Whether jurisdictional problems arising among regulatory bodies, can they be resolved by adopting super regulatory system in India?

(2) Which is more appropriate for the Indian financial regulation- Super Regulator or Lead Regulator?

Thus, a comparison with the financial system of the USA and the UK is done in order to determine the appropriate concept for India.

JURISDICTIONAL CONFLICTS BETWEEN REGULATORS

Owing to the conflicts which arose with regard to the jurisdictional issues between SEBI and other regulators, the Commission recommended for the merger of SEBI, FMC, IRDA and PFRDA under the common head referred to as UFA. Some of the recent examples include:-

(1) ULIPs case:-

The issue of deciding the jurisdiction between the two regulators SEBI and IRDA, with respect to Unit Linked Insurance Plan (ULIP). In exercise of the powers vested with the authority mentioned under the IRDA Act, 1999 under Section 34(1) (a) and (b) of the Insurance Act, 1938, IRDA shall continue to carry out insurance business as usual including offering, marketing and servicing of ULIPs.[3]

(2) SAHARA Case[4]

The issue arose with regard to the jurisdiction of SEBI in case of unlisted companies which had issued Optionally Fully Convertible Debentures (OFCDs). No conflict exist between the jurisdiction of MCA and the SEBI in the matters where interests of the investors are at stake. The SC observed that as per provisions of Section 55A of the Companies Act 2013[5], if any matter relating to the issue and transfer of securities and non-payment of dividend arises SEBI has the

[3] Jamshed Ansari, *Whether India Needs a Super Regulatory Body*, Academia Arena 6(4):74-79 (2014)
[4] *Sahara India Real Estate* Exchange Corpn. Ltd. v. SEBI, (2013) 2 SCC 733 (India)
[5] The Companies Act, 2013, No. 18, Acts of Parliament, 2018 (India)

power to administer in the case of listed public companies and also those companies which have intention to get the securities listed.[6]

(3) Chit Funds Scheme[7]-

The Saradha Chit fund scam was a ponzi scheme run under the guise of a collective investment scheme by the Saradha group along with 200 private companies in Eastern India. SEBI did not have jurisdictional authority therefore, an amendment under Section11AA of the SEBI Act, 1992 was made to incorporate CIS under the purview of SEBI jurisdiction.[8]

These examples highlight the continuing inadequacies in the regulatory architecture of India's financial sector and thus, there arose an issue of super regulator in India for which a recommendation was made in the FSLRC report for setting up of an UFA.

SUPER REGULATOR IN INDIA

a. Current Status in India

The financial system in India is regulated by independent and specialized regulators. The five major financial regulatory bodies in India are:-

(1) Reserve Bank of India

RBI is the apex monetary authority of India and it mainly focuses on the activities of supervision of financial institutions, consolidated accounting, divergence in activities of non-performing assets and act as a supervisory for rating models for banks.

(2) Securities and Exchange Board of India (SEBI)

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[6] Deepika V. Sawhney and Souvik Mukherjee, Sahara vs. SEBI-An In-Depth Analysis Of The Landmark Supreme Court Ruling - Corporate/Commercial Law - India, , http://www.mondaq.com/india/x/203796/Shareholders/Sahara+vs+SEBIAn+InDepth+Analysis+Of+The+Landmark+Supreme (last visited Sep 27, 2019).
[7]Romita Datta, *Saradha raised deposits from 1.7 mn people, probe finds,* MINT, Jun 21,2013, 12:51 AM
[8] Pranshu Paul, *Conflicts of jurisdiction between SEBI and other regulators,* India Law Journal (2007)

SEBI is a non-statutory body which mainly performs the function of regulating the securities market. Its main objective is to protect the interests of the investors in securities and to promote the development and regulation of securities market.[9]

(3) Insurance Regulatory and Development Authority (IRDA)

IRDA is a national agency of the government of India whose main objective is to regulate, promote and ensure orderly growth of the insurance industry as stated in the Preamble of the Act.[10]

(4) Forward Markets Commission (FMC)

FMC is a regulatory authority which is overseen by the Ministry of Consumer Affairs, Food and Public Distribution, Government of India. Its main objective is to regulate matters relating to forward contracts and also creating prohibition of option in goods as mentioned in the Preamble of the Act.[11]

(5) Pension Fund Regulatory and Development Authority (PFRDA)

PFRDA has been mainly established by the Government of India to promote old age income security by establishing, developing and regulating pension funds and to protect the interest of subscribers to schemes of pension funds.[12]

Thus, in India there are several agencies entrusted with the regulation and supervision of different institutions and market participants in financial sector. While every regulator may have some specific objective, but the common concern for them is maintaining financial stability. With the increasing tussle between the various regulators on jurisdictional issues, there arose a need to a mechanism which would resolve such issues. FSLRC report is one such step taken by the Government of India, wherein recommendations have been made on this issue.

b. <u>Comparison of the concept with other countries</u>

(1) <u>The USA:-</u>

[9] Preamble, SEBI Act, 1992, No. 15, Act of Parliament, 2016 (India).
[10] Preamble, IRDA Act, 1999, Act of Parliament (India).
[11] Forward Contracts (Regulation) Act, 1952, No. 74, Act of Parliament (India).
[12] PFRDA Act, 2013, Act of Parliament (India).

In the aftermath of the financial crisis of 2008, the US financial sector regulation has undergone major changes. The Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA) was passed on July 21, 2010[13]. This law was mainly passed to address the loopholes which remained in the regulations before the crisis. Therefore, the regulation in the USA can be studied under two heads:-

(a) Before the financial crisis of 2008

Glass- Steagall Act (GSA) is a 1933 law that separated investment banking from commercial banking. The function of investment banks were to organize the IPO, facilitate mergers and acquisitions and to operate their own hedge funds. On the other hand, commercial banks took deposits, managed checking accounts, and made loans. Also, an amendment was added which permitted bank deposit insurance, creating the Federal Deposit Insurance Corporation (FDIC).[14]

In the late 1970s and the 1980s, commercial banks could not compete with non-deposit taking financial firms. Thus, the US Government deregulated banking further in 1999 by passing the Financial Services Modernization Act (also referred to as Gramm-Leach-Billey Act (GLBA), which repealed the GSA and erased the distinction between commercial and investment banks.[15]

(b) After the financial crisis of 2008

After the crisis there was a need to repeal or revise the GLBA. Regulators are mainly categorized into three broad areas of finance:-

(1) Banking (Depository) Regulators
(2) Securities Regulators
(3) Insurance Regulators

Apart from the three, there are targeted Regulators

- for specific financial activities(Consumer Protection)
- for markets(Agricultural Finance and Housing Finance)

[13] Dodd-Frank Wall Street Reform And Consumer Protection Act, 12 USC (July 21,2010).
[14] Bhagwati, Jaimini & Khan, Shuheb & Bogathi, Ramakrishna, *Financial Sector Legislative Reforms Commission (FSLRC) & Financial Sector Regulation in* India, 10.13140/RG.2.1.4628.1844.
[15] Marc Labonte, *Who Regulates Whom? An Overview of the U.S. Financial Regulatory Framework*, Congressional Research Service Report (Aug 17, 2017).

(1) <u>Banking/Depository Regulators</u>

The US banking system comprises the Federal Reserve System, commercial banks, savings institutions and credit unions. The whole system is regulated at both federal and state levels. The regulators includes:-

- **Federal Reserve Board**

The central bank of the US commonly referred to as Fed. The Fed is responsible for regulating the U.S. monetary system as well as monitoring the operations of holding companies, including traditional banks and banking groups

- **Office of Controller of Currency**

OCC is a bureau of the Treasury Department. The principal function of the OCC is to regulate the national banking system and agencies of foreign banks. In regulating national banks, OCC has the power to

- Examine banks;
- Approval or denial of changes in the banking structure.
- Supervisory actions against banks that don't comply with the rules.
- Issue rules and regulations for the governance of bank investments, lending and other practices.[16]

After the enactment of DFA, the OCC is the primary regulator for federally chartered thrift institutions.

- **Federal Deposit Insurance Corporation**

FDIC is a federal government agency that provides insurance protection for depositors at most commercial banks and mutual savings banks. It is managed by a five-member Board of Directors appointed by the US President and confirmed by the Senate.[17]

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[16]Ms Vicky Lee, Legislative Council Secretariat (Mar 28, 2001)
Source- http://www.senate.gov/~banking/conf/grmleach.htm.
[17] Lee Hudson Teslik, *The U.S. Financial Regulatory System*, Council on Foreign Relations (Oct 1, 2008).

- **National Credit Union Administration**

NCUA is an independent federal agency that is responsible for chartering and supervising U.S. credit unions. It also insures savings in all federal- and most state-chartered unions through a fund called the National Credit Union Share Insurance Fund.[18]

(2) <u>Securities Market Regulators</u>

Under the securities market, for the regulatory purposes it is divided into derivatives and other types of securities. While derivatives are regulated by the CFTC or the SEC, other types of securities fall under the SECs jurisdiction.

- **Commodities Futures Trading Commission**

CFTC is an independent agency founded in 1974 whose function was to provide a regulatory framework for the futures contracts. The Dodd-Frank Act expanded the CFTC's jurisdiction by eliminating exemptions for certain over-the-counter derivatives.[19] As a result, registration is required with CFTC by swap dealers, major swap participants, swap clearing organizations, swap execution facilities, and swap data repositories.

- **The Securities and Exchange Commission**

SEC mainly performs the function of protecting the investors and maintaining integrity in the securities market. The SEC establishes rules that regulate procedures and standards for a variety of activities. These include rules for short selling, solicitations, rights distributions, confirmation procedures, proxy solicitation, tender offers, net capital requirements for securities firms and broker-dealers etc.[20] The SEC has jurisdiction over the following:

- Participants in securities markets
- Securities markets (e.g., stock exchanges) and market utilities (e.g., clearinghouses) where securities are traded, cleared, and settled; and

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[18] *S*upra n. 14.
[19] CRS Report R41398, The Dodd-Frank Wall Street Reform and Consumer Protection Act: Title VII, Derivatives, by Rena S. Miller and Kathleen Ann Ruane.
[20] *S*upra n. 14

- Securities products (e.g., money market accounts and security-based swaps).[21]

(3) Insurance Regulator

Insurance companies, unlike banks and securities firms, have been chartered and regulated solely by the states for the past 150 years.[22] Although each state sets its own laws and regulations for insurance, the National Association of Insurance Commissioners (NAIC) acts as a coordinating body that sets national standards through model laws and regulations. Models adopted by the NAIC, however, must be enacted by the states before having legal effect, which can be a lengthy and uncertain process.

(4) Consumer Protection Regulator

- **Bureau of Consumer Financial Protection (CFPB)-**

Title X of the Dodd-Frank Act created the CFPB to enhance consumer protection and bring the consumer protection regulation of depository and non-depository financial institutions into closer alignment.[23]

The DFA consolidated the agencies which were related to consumer protection and created a new agency referred to as CFPB. The primary responsibilities includes:-

- Writing of rules, regulating companies and enforcing consumer laws.
- Curbing of illegal and unfair means.
- Recognition of consumer complaints.
- Promotion of financial education.
- Monitoring of financial markets

(5) Regulatory Umbrella Groups

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[21] *S*upra n. 16
[22] Baird Webel, *Introduction to Financial Services: Insurance Regulation*, CRS In Focus IF10043.
[23] David H. Carpenter, *The Consumer Financial Protection Bureau (CFPB): A Legal Analysis*, CRS Report R42572.

Under the DFA, there arose a need for co-ordination among regulators which led to the formation of innumerable inter-agency task forces to study particular market episodes. Three inter-agency organizations have permanent status: the Financial Stability Oversight Council, the Federal Financial Institution Examination Council, and the President's Working Group on Financial Markets.[24] However, the Working Group is not in much operation. The USA blends functional regulation with umbrella supervision. Thus, the system of lead regulator is more prevalent in the USA.

(2) The UK:-

(a) Before the 2008 crisis

The Financial Services Authority (FSA) was responsible for regulating the financial sector based on the Financial Services and Markets Act, 2000 (FSMA). FSA has been criticized because of the failure on its part to detect and prevent the financial crisis. Thus, there arose a need for the bringing in the new legislation in order to overcome the loopholes that arose and led to the 2008 crisis.

(b) After the 2008 crisis

(1) Banking Regulator

Financial Services Act, 2012 was passed which abolished the FSA and created three new regulatory bodies- Bank of England (BoE), Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA).

(1) The BoE is entrusted with the primary responsibility for regulatory intervention and exercise of resolution powers in relation to banks. A Committee is formed within the BoE, responsible for scanning the emerging risks to the financial system and for providing strategic direction for the regulatory regime.

[24] *Supra* n. 16

(2) The PRA is a subsidiary of the Bank of England (BoE) and it has three statutory objectives as mentioned in the PRAs 2014 annual report:-

- A general objective to promote the safety and soundness of the firms it regulates;
- An objective specific to insurance firms, to contribute to the securing of an appropriate degree of protection for those who are or may become insurance policyholders; and
- Final report of the Parliamentary Commission on Banking Standards recommended a new secondary competition objective for the PRA.[25]

(3) The FCA has an overarching strategic objective to "ensure that the relevant markets function well".[26] It also has three operational objectives:

- Consumer protection: securing an appropriate degree of protection for consumers.
- Integrity: protecting and enhancing the integrity of the UK financial system.
- Competition: promoting effective competition in the interests of consumers in the markets for: regulated financial services and services provided by a recognized investment exchange.[27]

(2) <u>Insurance Regulator</u>

PRA and FCA regulates the Insurance sector in the UK. While the main objective of PRA is to focus on the resilience of the sector, the FCA tries to ensure that customers are treated fairly. PRA requires insurers to maintain continuity of financial services for which it sets rules and standards for the firms to follow.[28]

(3) <u>Market Regulator</u>

Under the FSA, 2012, FCA is responsible for the regulation of commodity derivatives. It mainly supervises firms and market operators and works closely with other countries'

[25] *Annual Report and Accounts for the year ended 28 February 2014*, Prudential Regulation Authority (Oct 4, 2019, 10:00 PM)
[26] *The UK's New Financial Services Regulatory Landscape*, Policy Briefing The UK's new financial services regulatory landscape, the Chartered Insurance Institute, (Oct 4, 2019, 10;01 PM) https://www.cii.co.uk/media/4372607/regulatory_landscape_update_april_2013_vfonline.pdf.
[27] *Id.*
[28] *The Prudential Regulation Authority's approach to Insurance Supervision,* Bank of England (2014).

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counterparts and physical market authorities such as the Office of the Gas and Electricity Markets (Ofgem).[29]

Thus, the concept of single regulator is prevalent in the UK where the authority is given the power to regulate the banking, insurance and market sector. Here, the banking, insurance and market regulators are under the authority of PRA working alongside with the FCA. Both PRA and FCA work closely together in the authorization process, the PRA is required to obtain the permission of FCA before granting any permission.[30] Thus, UK follows the concept of "super regulator" where a single unified agency is entrusted with the financial regulation of the country.

c. Super Regulator V. Lead Regulator: An analysis

The term "Super Regulator" refers to the structure that combines regulation in respect of all the two or three supervisory responsibilities relating to banks, securities firms and insurance companies. However, in the case of "lead regulator," individual regulatory agencies continue to exist, while one of the regulators is selected to coordinate the regulation and to have a wide group assessment. Thus, the lead regulator does not intend to interfere with the powers and responsibilities of the individual supervisors.[31]

For India, the concept of "super regulator" does not seem to be appropriate because of the following reasons:-

(1) As all the regulators are expertise in their sector and have the exclusive jurisdiction. Interference of one regulator with the functioning of other regulators would hinder the functioning of the financial system.

(2) The UFA for India, may be a regulatory monopoly, which may give rise to the inefficiencies which are usually associated with monopolies.

(3) Creation of a unified agency may lead to unpredictability of the change in the process and management of the financial system.

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[29] *FCA Annual Report 2013-14*, Financial Conduct Authority.

[30] Simon Lovegrove and Alan Brainbridge, Banking Regulation 2019- United Kingdom, Global Legal Insights (last visited- Oct 8, 2019)

[31] Janak Raj, *Is There A Case For a Super Regulator in India?* , Economic and Political Weekly (Aug 27, 2005).

Thus, in order to overcome these loopholes India can establish an authority similar to that which has been established in the USA. FSLRC has made a recommendation for the establishment of Financial Stability and Development Council (FSDC) which would act as a "lead regulator" in India. Its main function is to maintain stability among the regulators and to increase cooperation among them. In this way, without interference with the individual regulator's functioning a check can be kept by a monitoring authority.

CONCLUSION:-

The jurisdictional conflicts that exist among the regulators in India arose with the issue that either India should adopt the concept of super regulator as prevalent in the UK or India should bring in the concept of lead regulator which exists in the USA. In USA, FSOC has been established under DFA, which is entrusted with the monitoring of the stability of the financial system. This authority is a lead regulator which doesn't interfere with the functioning of the other regulators. The UK, on the other hand, has adopted the concept of super regulator, there exist FCA and PRA, which have been entrusted with the management of banking, insurance and securities market in the UK. Establishing a super regulator in India will lead to increase in the hierarchy of the financial market regulatory system and also increase in the procedural formalities. At this time, it will be appropriate to continue with the existing system, rationalize with the overlap which exist. Thus, a system of "lead regulator" can be an appropriate choice for India.

SUGGESTIONS

India doesn't require a super regulator for financial sector markets but a proper coordination is required among the existing regulators. To avoid the duplicities or the overlaps, there is a need to adopt a formal mechanism among the three major regulators. Following measures can be adopted:-

(1) Establishment of Financial Stability and Development Council (FSDC), an apex regulatory body, similar to FSOC in the USA, for formulating broad macro-policies and giving the financial market a direction without prejudice to the authorities of the existing regulators.
(2) Unification of support services, wherein the regulators may act as separate entities, but will have a shared infrastructure and support services.
(3) Having a Memorandum of Understanding, in order to facilitate cooperation between government and other regulators, so as to facilitate accountability, transparency and no duplication among regulators.

Financial sector reforms have been introduced in India as a part of the liberalization policy. However, there still exist jurisdictional conflict between regulators which needs to be reformed.

Thus, the ambiguity exist with regard to implementation of FSLRC, which warrants proper steps on the part of the government to be followed.