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Theme 267

FINANCIAL STABILITY AND DEVELOPMENT COUNCIL (FSDC)

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SIB STUDENTS' ECONOMIC FORUM

FEBRUARY 2014

Theme No. 267 : Financial Stability And Development Council (FSDC)

A well informed customer will make the policy makers as well as organisations which produce goods and services more responsive to the customer needs. This will also result in healthy competition among organisations and improve the quality of goods and services produced. The "SIB Students' Economic Forum" is designed to kindle interest in economic affairs in the minds of our younger generation. We highlight one theme in every monthly meeting of the "Forum". Financial Stability and Development Council is apex-level body constituted by Government of India. The global economic meltdown has put pressure on governments and institutions across the globe to regulate the economic assets. This council is seen as an India's initiative to be better conditioned to prevent such incidents in future.

What is the objective of forming the council?

The Council will pursue the objective of fostering the stability and resilience of the financial system, by identifying and monitoring systemic risk and taking all required action to eliminate or mitigate systemic risk. The Council must have regard to India's international obligations, as relevant, in the process of achieving its objective.

How does the council function?

The office of the Council will consist of the Council Board, an Executive Committee, a Secretariat, and a Data Centre. The Council Board must publish a report within thirty days of the beginning of every financial year to disclose all delegations to the office of the Council, or by the office of the Council for the previous financial year.

- Chairperson: The Union Finance Minister of India
- Members: Governor Reserve Bank of India (RBl), Finance Secretary and/ or Secretary, Department of Economic Affairs (DEA), Secretary, Department of Financial Services (DFS), Chief Economic Advisor, Ministry of Finance, Chairman, Securities and Exchange Board of India (SEBI), Chairman, Insurance Regulatory and Development Authority (IRDA), Chairman, Pension Fund Regulatory and Development Authority (PFRDA).
- Joint Secretary (Capital Markets), DEA, will be the Secretary of the Council.
- The Chairperson may invite any person whose presence is deemed necessary for any of its meeting(s).
- The Secretariat will assist the Council in the performance of its functions under this Act. The Secretariat will be headed by the Council Chief Executive.
- The data centre, by the name of the Financial Data Management Centre will be headed by a Data Centre Director who will be appointed by the Council Board

What are the major responsibilities of the council?

Financial Stability ,Financial Sector Development, Inter-Regulatory Coordination, Financial Literacy, Financial Inclusion, Macro prudential supervision of the economy including the functioning of large financial conglomerates, coordinating India's international interface with financial sector bodies like the Financial Action Task Force (FATF), Financial Stability Board (FSB) and any such body as may be decided by the Finance Minister from time to time.

What are the functions of the council?

The major functions of the council are 1) Conducting data analysis and research; 2) Designating financial service providers as Systemically Important Financial Institutions; 3) Formulating and implementing the application of system-wide measures to the financial system; 4) Promoting co-operation and co-ordination among members and financial agencies; 5) Assisting the members and Financial Agencies in the performance of their functions; 6) Assisting the Central Government, members and Financial Agencies during a financial system crisis; and 7) Ensuring the performance of all other actions that are required to be undertaken by the Council.

How does the council discharge the responsibilities?

The Council must, while discharging its functions and exercising its powers ensure that its actions a)take into account the principles of proportionality between the costs imposed and the benefits expected to be achieved b)seek to reduce the potential for regulatory inconsistencies; *c*) do not cause a significant adverse effect on the competitiveness of the financial system; *d*) do not cause a significant adverse effect on the growth of the financial system in the medium or long-term; and *e*) lead to greater transparency and sharing of material information in relation to the financial system.

How is the data analysis and research undertaken?

The Council must monitor and analyse all accessible data, and conduct such research, as is relevant to the achievement of its objective. The functions of the Council relating to the monitoring and analysis of accessible data and conducting research include –developing expertise and information systems to monitor and conduct statistical, mathematical, financial and related analysis of accessible data; identifying trends in the financial system that assist in the identification, measurement, and monitoring of systemic risk in the financial system; developing system-wide measures, systemic indicators for designating Systemically Important Financial Institutions, and other tools that may be used to eliminate or mitigate systemic risk in the financial system;studying the impact on the financial system of any measures, systemic indicators, or tools that have been developed on the financial system; and analysing international best practices for the efficient discharge of its functions. The Council must publish the results of its data monitoring, data analysis and research frequently, and at least once every one hundred and eighty days.

How does the council determine the systemic indicators?

The Council must specify the systemic indicators for designating financial service providers as Systemically Important Financial Institutions.

- The nature of the financial service or financial product provided, if any, by the financial service provider;

- The size of the financial service provider;
- The interconnectedness of the financial service provider with the financial system, and other parts of the economy;
- The substitutability of the financial service, the financial product or the financial service provider in the financial system; and
- Any additional factors as may be specified.

What are the major requirements in the draft regulations?

(*a*) A statement explaining the application of the systemic indicators to the data of various categories or classes of financial services, financial products and financial service providers;

(*b*) The time-period within which the Council will designate financial service providers as Systemically Important Financial Institutions;

(*c*) The conditions and process of deciding requests for exemption from such designation; and

(*d*) The time-period within which the Council will convey its decision in relation to any requests for exemption from such designation.

How does the council review the application of systemic indicators to financial service providers?

The Council must review as frequently as required and at least once every financial year, the applicability of the systemic indicators to financial service providers to identify which financial service providers are to be designated as Systemically Important Financial Institution. If the Council proposes to designate a financial service provider as a Systemically Important Financial Institution it must issue a show cause notice to such financial service provider. If the Council decides to designate a financial service provider as a Systemically Important Financial Institution it must issue a decision order. If any Systemically Important Financial Institution carries out a financial service that is not allocated to a Regulator, the Council must, identify the Regulator who will regulate such Systemically Important Financial Institution.

How does the council implement the system- wide measures?

The Council may, by order in writing, direct the implementation of a system-wide measure, if it determines that such implementation is required to achieve the Council's objective. The order identifies the parameters of application of the system-wide measure and the Financial Agencies that will implement such system-wide measure. The order directs the Financial Agencies to exercise their powers to ensure the implementation of such system-wide measure. It allocates specific implementation to specific Financial Agencies, if the measure requires implementation by more than one Financial Agency. It also directs the Financial Agencies to monitor and review the implementation of the system-wide measure and report to the Council as frequently, and in such form and manner, as may be provided for in the order. The existence of the order is relevant to the exercise of any discretion conferred on the Financial Agencies. The Council must regularly and at least once every financial year, review the effectiveness of all orders issued. If the Council determines that a specific system-wide measure no longer contributes to its objective, then it must revoke the implementation of such system-wide measure, through an order in writing, to the Financial Agencies directed to implement the system-wide measure or suitably modify such system-wide measure in accordance with the procedure, before ordering the implementation of the modified system-wide measure. The Council must conduct an analysis of the impact of any revoked or modified system-wide measure within one year of such revocation or modification. Any action to be taken by the Council under this section must only be taken by the Council Board.

How does the council facilitate co-ordination and co-operation?

The Council must facilitate co-ordination and co-operation among Financial Agencies. The functions include 1) the review and examination of concerns of regulatory inconsistencies; 2) the identification of gaps in actions of the Financial Agencies in dealing with similar matters; and 3) the facilitation of knowledge-sharing and cross-staffing.

The Council may, upon direction from, or in consultation with, the Central Government co-ordinate and co-operate with, and represent India at, specified international forums and foreign regulatory bodies, as may be necessary to achieve its objective; seek to initiate knowledge-sharing and cross-staffing with international forums and foreign regulatory bodies, as may be necessary to achieve its objective.

How are the disputes resolved by the council?

The Council Board must resolve any dispute between two or more of its members or between any of its members and other Financial Agencies, or between Financial Agencies only if at least one of the following conditions is met.

(*a*) A member or a Financial Agency submits a written request to the Council Board for the determination of such dispute; or

(*b*) In the opinion of the Council Board, a dispute exists between two or more of its members, or between any of its members and other Financial Agencies, or between Financial Agencies, that has the potential to cause regulatory uncertainty and adversely impact the stability of the financial system.

The Council Board must resolve all disputes as soon as possible and at least within one year of publishing the procedure of dispute resolution. In resolving a dispute the Council Board must ensure that, where a dispute relates to any action taken by a Financial Agency including the extent of jurisdiction of a Financial Agency in taking such action, the decision of the Council Board does not exempt the statutory duties of a party to the dispute; or divest a party to the dispute of any authority derived from this Act, or any other law currently in force.

What is the role of the council during a financial system crisis?

The Council must specify, as frequently as appropriate, the parameters for the identification and determination of a financial system crisis. The Council must specify, in preparation for assistance during a financial system crisis, a statement of action in relation to potential financial system crises. The statement of action must be updated every financial year and take into account international best practices in relation to assistance during various types of financial system crises.

Financial Stability Report – December 2013 : Major Highlights:

- The US Federal Reserve tapering in its bond purchase programme is set to begin from January 2014. However, financial market volatility will be conditioned by the pace of tapering going forward. The delay in tapering allowed India to bring about adjustment in the current account deficit (CAD) and build buffers by replenishing its foreign exchange reserves. However, macro-economic adjustment is far from complete, with persistence of high inflation amidst growth slowdown. Fall in domestic savings and high fiscal deficit are other major concerns for India. Realignment of global growth as well as high inflation differential between advanced economies (AEs) and Emerging Markets and Developing Economies (EMDEs) is a potential source of exchange rate volatility and may result in volatile cross-border flows with every re-pricing of risk.

- Corporate performance continues to be weighed down by boom period expansions and excess capacities, amid shifting asset composition towards financial investments. House prices and outstanding loans for housing by housing finance companies have grown relatively faster during the last few years. Inadequate social security coverage in India against a backdrop of changing demographics will pose challenges for expanding the pension system (NPS) given the fiscal constraints. All major risk dimensions captured in the Banking Stability Indicator show increase in vulnerabilities in the banking sector. Failure of a major corporate or a major corporate group could trigger a contagion in the banking system due to exposures of a large number of banks to such corporates.

- Asset quality continues to be a major concern for Scheduled Commercial Banks (SCBs). The total stressed advances ratio rose significantly to 10.2 per cent of total advances as at end September 2013 from 9.2 per cent of March 2013. Five sectors, namely, Infrastructure, Iron & Steel, Textiles, Aviation and Mining together contribute 24 percent of total advances of SCBs, and account for around 53 per cent of their total stressed advances. Macro stress tests on credit risk suggest the credit quality of commercial banks could deteriorate further. However, under improved conditions, the present trend in credit quality may reverse during the second half of 2014-15.

- Due to the interconnectedness with banks, liquidity pressure is felt by the money market mutual funds (MMMFs) whenever redemption requirements of banks are large and simultaneous. Regulatory measures taken to reduce the degree of interconnectedness seem to have been successful in reducing the liquidity risk in the system. Action to create central repositories for the banking sector, corporate bond market and insurance sector has been initiated. It has been observed that the equity prices of the companies in which the promoters had pledged significant portions of their shares, are relatively more volatile than the broader market during times of correction.

Source: http://rbi.org.in/scripts

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