

# The Indian financial reforms: A status report

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# Measuring outcomes

- There are many good measures of outcomes.
- *Example:* To measure the outcomes associated with the bankruptcy process, we would look at the recovery rate.
- *Example:* To measure the outcomes associated with financial markets reform, we would measure various notions of liquidity (depth, resilience).

## The outcome is not shaped by policy alone

- In the US, securities are big, so fairly shabby financial markets give good liquidity.
- In Sri Lanka, it's very hard to make an index futures market liquid.
- Further, macroeconomic conditions matter.
- E.g. in a crisis, bankruptcy process would do fire sales and the recovery rate would go down.

Hence: We should measure the *inputs* by policy makers. The outcomes do not uniquely identify the inputs.

# What should we look for in financial reforms?

Three components:

- 1 Legal foundations
- 2 Markets
- 3 Financial firms

# Legal foundations

- 1 Governance of financial agencies
- 2 Legislative, executive, judicial processes
- 3 Consumer protection
- 4 Micro-prudential regulation
- 5 Development
- 6 Capital controls
- 7 Resolution
- 8 Financial redress
- 9 Monetary policy
- 10 Public debt management
- 11 Financial regulatory agency
- 12 Council of regulators for systemic risk regulation
- 13 Systemic risk data centre
- 14 Appellate Tribunal
- 15 SOEs as ordinary companies
- 16 Ministry of Finance restructuring

# Markets

- 1 Equities
- 2 Bond-Currency-Derivatives Nexus
- 3 Commodities

# Financial firms

- 1 Banks
- 2 Payments
- 3 Insurance
- 4 Mutual funds
- 5 Pensions.

# The Indian story on legal foundations

- Fairly shabby beginning
- Expert committee reports – Percy Mistry, Raghuram Rajan, D. Swarup, U. K. Sinha, some others.
- FSLRC: Volume 1 with concepts and arguments, and version 1.0 of Indian Financial Code
- Version 1.1 of Indian Financial Code: A mature model law.



# State of progress

- 1 RBI CPI inflation targeting
- 2 Monetary policy committee
- 3 Financial Sector Regulatory Appointment Search Committee (FSRASC).
- 4 Merged FMC into SEBI
- 5 Moved capital controls regulation-making power for non-debt flows to MOF from RBI.
- 6 Budget 2015: Setup PDMA, shift bond market from RBI to SEBI: Rolled back.
- 7 MOF setup five 'Task Forces' for setting up RC (M. Damodaran), FDMC (Subir Gokarn), FRA (D. Swarup), PDMA (D. Swarup), FSAT (Justice Sodhi).
- 8 RC draft law on MOF website.
- 9 Some movement on FDMC.
- 10 4 October 2016: Revival of the PDMA project.

# Markets

## Equities

- 1 Decent foundations; one key piece missing – securities lending.
- 2 Mistakes: margins, time of day, taxation of non-residents.
- 3 Decent liquidity
- 4 Losing ground to the overseas market.
- 5 Badly need better processes at SEBI and RBI.

## Bond-Currency-Derivatives Nexus

- 1 Mostly faulty.
- 2 INR is a big market, that's giving liquidity.
- 3 Bond market is mostly broken.

## Commodity futures

- 1 Commodity futures merged into the main financial market system, *de jure* but not *de facto*.

# Financial firms

**Banks** Entry barriers, inefficiencies, SOE domination.

**Payments** Captured by banks.

**Insurance** Problems of consumer protection, concerns about micro prudential regulation.

**Mutual funds** Working reasonably well; need to strengthen SEBI processes.

**Pensions** Early foundations of NPS laid, now need to see this through in its original vision.

# Scorecard for Legal foundations

Governance of financial agencies	33
Legislative, executive, judicial processes	33
Consumer protection	33
Micro-prudential regulation	33
Development	33
Capital controls	40
Resolution	40
Financial redress	40
Monetary policy	55
Public debt management	40
Financial regulatory agency	40
Council of regulators for systemic risk regulation	40
Systemic risk data centre	40
Appellate Tribunal	50
SOEs as ordinary companies	15
Ministry of Finance restructuring	15
Overall	38.3

# Markets

Equities	70
Bond-Currency-Derivatives Nexus	20
Commodities	40
Overall	44

# Financial firms

Banks	30
Payments	40
Insurance	50
Mutual funds	70
Pensions	50
Overall	48

# Overall

Legal foundations	38
Markets	44
Financial firms	48
Overall	45

# Part I

## Quantification



## Example: Bankruptcy reform

1. Get the ideas straight	BLRC v1
2. Get a good draft law	IBC dragon edition (90%), BLRC v2 (80%)
3. Enact a law	IBC, 2016 (70%)
4. Implement the law	We have an early stage IBBI: 10%
5. Measure outcome	Recovery rate?

## This suggests a report card

Component	Weight	Score
Ideas	5	100
A good model law	5	90
Enact the law	10	70
Implement it	10	10
Overall status	30	<b>58.33</b>

By watching the history of each component, we can make a *time series* of an index of bankruptcy policy reform.

# Designing a financial reforms index

Three components:

- 1 Legal foundations  
For all sub-components: (a) Concepts (b) Model law drafted (c) Law enacted (d) Law implemented.
- 2 Markets  
For all sub-components: (a) Market infrastructure (b) Intermediation (c) Regulatory structure (d) Regulations (e) Enforcement.
- 3 Financial firms.  
For all sub-components: (a) Licensing, entry barriers (b) Regulatory structure (c) Regulations (d) Enforcement.

## Part II

### Example: Monetary policy

# Monetary policy : Concepts

- 1 10/2/2007: Percy Mistry report: First proposal for inflation targeting. **10%**
- 2 12/9/2008: Raghuram Rajan report: Second proposal for inflation targeting. **20%**
- 3 22/3/2013: FSLRC: Full picture of inflation targeting RBI. **100%**.

# Monetary policy: Draft law

- 1 22/3/2013: FSLRC v1: A first complete monetary policy draft law. **90%.**
- 2 23/7/2015: IFC v1.1. **100%.**

## Monetary policy: Law enacted

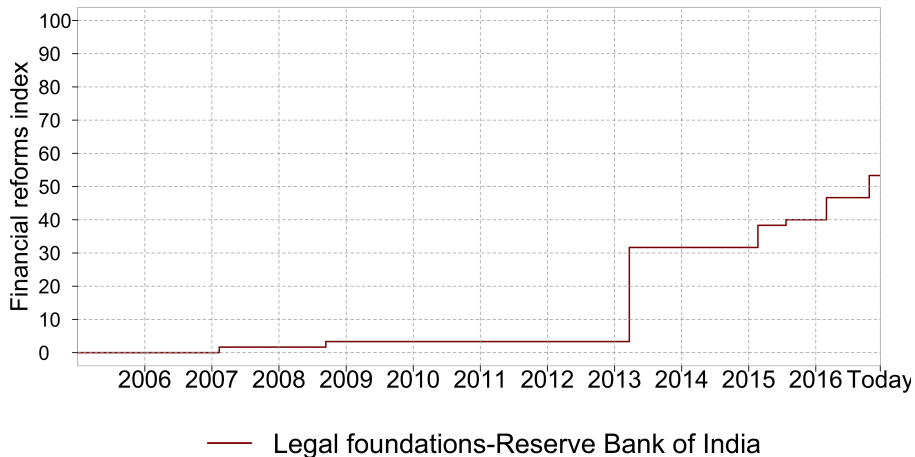
- 1 20/2/2015: Monetary policy framework agreement. **20%**.
- 2 28/2/2016: RBI Act amended with IT and MPC. **100%**.

# Monetary policy: Law enforced

- 1 18/10/2016: 1st MPC meeting. **20%**.



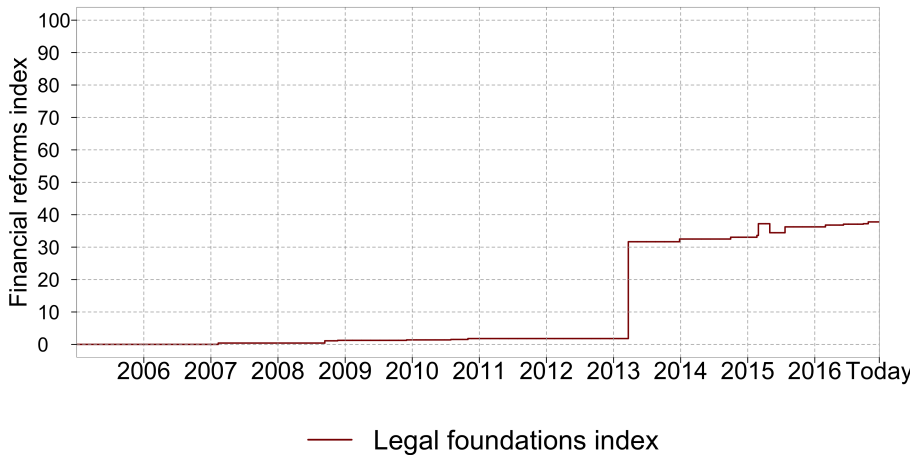
# Index of legal foundations for monetary policy



## Part III

# Extending this to the full legal foundations

## Index of legal foundations (only 14 of 16)



# Conclusion

- It's useful to think systematically about the *inputs*, the financial sector reforms that will set the stage for good *outcomes* like efficiency, inclusion, stability.
- In each sub-component, this requires a chronology, an economic history.
- We will soon release an R program and associated JSON file format through which such information systems can be created and manipulated.

Thank you.

<http://ajayshahblog.blogspot.com>