OVERVIEW OF THE DRAFT INDIAN FINANCIAL CODE, 2013

Rajkumar S. Adukia

B. Com. (Hons.), FCA, ACS, AICWA, LL.B, Dip.IFR (UK), MBA

Mobile +91 98200 61049/+91 93230 61049

Fax +91 22 26765579

Email rajkumarfca@gmail.com

www.carajkumarradukia.com

http://rishabhacademy.com

Index

1. INTRODUCTION

Financial system is basically a set of complex and closely interconnected financial institutions, markets, instruments, services, practices, and transactions. It is crucial to the in a modern economy. They channel household savings to the corporate sector and allocate investment funds among firms; they allow inter temporal smoothing of consumption by households and expenditures by firms; and they enable households and firms to share risks. These functions are common to the financial systems of most developed economies.

India has a financial system that is regulated by independent regulators in the sectors of banking, insurance, capital markets, competition and various services sectors. Ministry of Finance, Government of India looks after financial sector in India. Reserve bank of India (RBI) established in 1935 is the Central bank and is the regulator for financial and banking system, formulates monetary policy and prescribes exchange control norms. Non-banking Financial Institutions provide loans and hire-purchase finance, mostly for retail assets and are regulated by RBI. Insurance Development and Regulatory Authority (IRDA) is the regulatory authority in the insurance sector under the Insurance Development and Regulatory Authority Act, 1999. Securities and Exchange Board of India (SEBI) established under the Securities and Exchange Board of India Act, 1992 is the regulatory authority for capital markets in India.

1.1. Financial services sector of India

Comprising primary markets, foreign direct investments (FDI), alternate investment options, banking, insurance and asset management segment, the Indian financial services sector is one of the oldest and robust across the globe. It is the most fast growing and best among other emerging economies. One of the key reasons for India’s endurance is its demographics. 60% of India’s population is under the age of 30 years. India also has a strong middle class, which is currently at 250 million and is expected to rise to 800 million by 2030. The services sector, which contributes close to 60% of the GDP, continues to be a key growth driver of which, financial services is a significant component. The rising purchasing power of the Indian consumer due to increasing incomes and improved affordability has assured the exponential growth of the financial services sector in the coming years.

India is highly preferred as an investment destination as the savings rate is high (25 per cent plus) and financial products' penetration is low. Hence, it is a vast market for mutual funds, portfolio and wealth management services, insurance and a plethora of other financial products.

1) Banking

According to the Reserve Bank of India (RBI)'s 'Quarterly Statistics on Deposits and Credit of Scheduled Commercial Banks', March 2012, Nationalised Banks accounted for 53.0 per cent of the aggregate deposits, while the State Bank of India (SBI) and its Associates accounted for 21.8 per cent. The share of New Private Sector Banks, Old Private Sector Banks, Foreign Banks, and Regional Rural Banks in aggregate deposits was 13.0 per cent, 4.8 per cent, 4.4 per cent and 3.0 per cent, respectively.

Nationalised Banks accounted for the highest share of 52.0 per cent in gross bank credit followed by State Bank of India and its Associates (22.5 per cent) and New Private Sector Banks (13.5 per cent). Foreign Banks, Old Private Sector Banks and Regional Rural Banks had shares of around 4.8 per cent, 4.8 per cent and 2.4 per cent, respectively.

India's foreign exchange (forex) reserves stood at US$ 292.64 billion for the week ended March 29, 2013, according to data released by the central bank. The value of foreign currency assets (FCA) - the biggest component of the forex reserves - stood at US$ 259.72 billion, according to the weekly statistical supplement released by the RBI.

2) Insurance

Life insurance industry, comprising over 20 companies, including public sector Life Insurance Corporation (LIC) of India, collected total premium of Rs 84, 501.75 crore (US$ 15.48 billion) during the April-February period of 2012-13 fiscal. Private insurers together raked-in Rs 23, 796.29 crore (US$ 4.36 billion) in these 11 months.

On the other hand, Indian general insurers' premium collection rose 19.36 per cent to Rs 561.1 billion (US$ 10.28 billion) in the April-January 2012-13.

Of the total, premium collection of the four state-run general insurers rose 16.78 per cent to Rs 319.18 billion (US$ 5.85 billion) in the 10 months while that of 23 private sector non-life insurers increased 22.93 per cent to Rs 241.81 billion (US$ 4.43 billion) to Jan 31, 2013.

3) Mutual Funds

India's asset management companies (AMCs) have witnessed a growth of 19.5 per cent in their average assets under management (AUM) in FY13, wherein they stood at Rs 8.16 lakh crore (US$ 149.53 billion), as on March 31, 2013, according to the latest statistics available from industry body Association of Mutual Funds in India (AMFI).

4) Private Equity, Mergers & Acquisitions

Favourable demographics and growth opportunities keep India an 'attractive' destination for merger and acquisition (M&A) activities across diverse sectors including consumer goods and pharmaceuticals.

The value of M&A deals in India stood at US$ 4.5 billion in the March 2013 quarter, according to Thomson Reuters' India M&A First Quarter 2013 Review. Meanwhile, there were 90 private equity (PE) deals valuing US$ 1.04 billion during January-March 2013 quarter, reveal data from Four-S Services.

5) Foreign Institutional Investors (FIIs)

FIIs have infused US$ 26 billion in the Indian stock market during the fiscal ended March 31, 2013, according to latest data available with the market regulator Securities and Exchange Board of India (SEBI). The amount is the highest ever since overseas entities started investing in the country.

The number of registered FIIs in India stood at 1, 757 in FY 2012-13 while the number of FII sub-accounts rose to 6, 335, from 6, 322 at the end of 2011-12.

India’s bankable population has witnessed rapid strides in previous decade due to the growing demand for consumer loans, housing loans and credit cards. For instance, in the retail loans segment, mortgages have grown from 1.5% of banks’ advances to 10% of advances over the last ten years. The Boston Consulting Group estimates that outstanding mortgages will increase 8 fold from Rs. 5 trillion in 2011 to Rs. 40 trillion by 2020. Further, there will be a requirement of at least 40,000–50,000 additional bank branches and 160,000–

190,000 additional ATMs in this decade. This will be 3 times more than the branches and ATMs launched in the last decade.

Market estimates indicate that financial savings in India in the fiscal year 2000 was 45 billion USD out of which the net inflow into insurance was 5 billion USD. In the fiscal year 2010, financial savings amounted to 168 billion USD out of which the net inflow into insurance was 38 billion USD. It is estimated that by 2015, financial savings will amount to around 296 billion USD out of which the net inflow into insurance will be approximately 67 billion USD. This gives us a glimpse of the latent opportunity that lies ahead for the Indian life insurance industry at the current savings rate.

The Indian economy has shown resilience in the midst of a volatile global economic environment. In this scenario, a well-developed and evolved insurance sector is essential for economic development and for ensuring stability in the capital markets as it provides long term funds required for the development of core sectors. The life insurance industry is a major catalyst for the mobilization of savings of people, reaching out to the middle and lower income groups and channelizing these funds towards economic development. This industry has emerged as the largest and most relevant domestic institutional segment contributing to the stability of the capital markets owing to their sizable long term flows.

In India, capital markets have been playing an increasingly important role, determining the pace and pattern of economic growth and the stock exchanges are a vital institution of the capital markets. Although the cost of trading in Indian exchanges has declined over the years, it still remains relatively high compared to other countries, primarily because of persistently high statutory levies, particularly the Securities Transaction Tax. Over the years, the Indian exchanges have introduced a number of new products, which have added to the sophistication of the Indian capital markets. These products have served the new and diversified needs of the Indian investors and traders.

1.2. Financial sector reforms in India

The period immediately after independence posed a major challenge to the country. Due to centuries of exploitation at the hands of foreign powers, there were very high levels of deprivation in the economy—both social as well as economic. To take up the Herculean task of rapid growth with socio-economic justice, the country adopted the system of planned economic development after independence. Due to paucity of economic resources and limitations of availability of capital for investment, the government also came up with the policy of setting up public enterprises in almost every field.

The fiscal activism adopted by the government resulted in large doses of public expenditures for which not only the revenues of the government were utilized but the government also resorted to borrowing at concessional rates, which kept the financial markets underdeveloped. The growth of fiscal deficit also continued unabated year after year. Complex structure of interest rates was a resultant outcome of this system.

Nationalisation of major commercial banks in the late sixties and early seventies provided the government with virtually the complete control over the direction of the bank credit. The emphasis was mainly on control and regulation and the market forces had very limited role to play.

The economic system was working to the satisfaction of the government. The social indicators were gradually improving and the number of people below poverty line also declined steadily. The only problem area had been that the growth rate of the economy had been very low, and till late seventies, the growth rate of the GDP was hovering around 3.5 per cent per annum. It was only during mid-eighties that the growth rate touched 5 percentage points.

The situation became difficult by the eighties. Financial system was considerably stretched and artificially directed and concessional availability of credit with respect to certain sectors resulted in distorting the interest rate mechanism. Lack of professionalism and transparency in the functioning of the public sector banks led to increasing burden of non-performance of their assets.

Late eighties and early nineties were characterised by fluid economic situation in the country. War in the Middle East had put tremendous pressure on the dwindling foreign exchange reserves of the country. The country witnessed the worst shortages of the petroleum products. High rate of inflation was another area of serious concern. Most of the economic ailments had resulted due to over regulation of the economy. The international lending and assisting agencies were ready to extend assistance but with the condition that the country went in for structural reforms, decontrols and deregulation, allowing increased role for the market forces of demand and supply.

The precarious economic conditions left the country with no alternative other than acceptance of the conditions for introducing the reforms.

Post reforms, rationalisation of the taxes has already taken place on the basis of the recommendations of Raja Challiah Committee Report during mid-nineties. The government has been able to tighten its fiscal management and the continuing increase in the fiscal deficit has been contained significantly. Reforms in the external sector management have yielded results in the form of increased foreign capital inflows in terms of Foreign Direct Investment (FDI), Foreign Institutional Investment (FII) and the exchange rate has also represented true international value of Indian rupee vis-à-vis hard global currencies.

The primitive foreign exchange regulation regime controlled by FERA has been replaced by a liberalized foreign exchange rate management system introduced by FEMA. Introduction of such a modern management law was perhaps a pre-condition for allowing FDI and FII. In 1993, the RBI issued guidelines to allow the private sector banks to enter the banking sector in the country, a virtual reversal of the policy of bank nationalisation. Foreign banks were also given more liberal entry.

The thrust of the monetary policy after the introduction of the process of reforms has been able to develop several instruments of efficient financial management. A Liquidity Adjustment Facility (LAF) was introduced in June 2000 to precisely modulate short-term liquidity and signal short-term interest rates. A lot of reliance is being placed on indirect instruments of monetary policy. Strengthening and upgradation of the institutional, technological and physical infrastructure in the financial markets has also improved the financial framework in the country.

The introduction of financial sector reforms has provided the economy with a lot of resilience and stability. The average annual growth rate of the economy during the post-reform period has been more than 6 per cent, which was unimaginable a decade before that. The economy withstood boldly the Asian economic crisis of 1997-98. Even the economic sanctions by the US and other developed countries after the nuclear testing did not affect the economy to the extent apprehended. The current global slowdown and sub-prime crisis affecting the banking system all over the world has not impacted the Indian economy to that extent.

Banking and insurance sectors are booming. While the private and foreign banks are giving stiff but healthy competition to the public sector banks, resulting in overall improvements in the banking services in the country, the insurance sector has also witnessed transformation. The consumer is a gainer with the availability of much better and diversified insurance products.

2. FINANCIAL SECTOR LEGISLATIVE REFORMS COMMISSION (FSLRC)

The Financial Sector Legislative Reforms Commission (FSLRC) was constituted by the Government of India, Ministry of Finance; vide resolution dated 24th March 2011. The setting up of the FSLRC was the result of a felt need that the legal and institutional structures of the financial sector in India need to be reviewed and recast in tune with the contemporary requirements of the sector.

The institutional framework governing the financial sector has been built up over a century. There are over 60 Acts and multiple rules and regulations that govern the financial sector. Many of the financial sector laws date back several decades, when the financial landscape was very different from that seen today. For example, the RBI Act and the Insurance Act are of 1934 and 1938 vintage respectively. The Securities Contract Regulation Act was enacted in 1956, when derivatives and statutory regulators were unknown. The superstructure of the financial sector governance regime has been modified in a piecemeal fashion from time to time, without substantial changes to the underlying foundations. These piecemeal changes have induced complex and cumbersome legislation, and raised difficulties in harmonising contradictory provisions. Such harmonisation is imperative for effectively regulating a dynamic market in the era of financial globalisation.

The piecemeal amendments have generated unintended outcomes including regulatory gaps, overlaps, inconsistencies and regulatory arbitrage. The fragmented regulatory architecture has led to a loss of scale and scope that could be available from a seamless financial market with all its attendant benefits of minimising the intermediation cost. For instance, complex financial intermediation by financial conglomerates of today falls under the purview of multiple regulators with gaps and overlaps. A number of expert committees have pointed out these discrepancies, and recommended the need for revisiting the financial sector legislations to rectify them. The need for complete review of the existing financial sector laws has been underlined to make the Indian financial sector more vibrant and dynamic in an increasingly interconnected world.

The remit of FSLRC, as contained in its Terms of Reference (ToR), comprises the following:

1. Review, simplify and rewrite the legislations affecting the financial markets in India, focussing on broad principles.
2. Evolve a common set of principles for governance of financial sector regulatory institutions.
3. Remove inconsistencies and uncertainties in legislations/Rules and Regulations.
4. Make legislations consistent with each other.
5. Make legislations dynamic to automatically bring them in tune with the changing financial landscape.
6. Streamline the regulatory architecture of financial markets.

Based on substantive research, extensive deliberations in the Commission and in its Working Groups, interaction with policy makers, regulators, experts and stakeholders; the Commission evolved a tentative framework on the legal–institutional structure required for the Indian financial sector in the medium to the long run. The broad contour of that framework was outlined in the Approach Paper released by the Commission in October 2012.

The Approach Paper emphasised the following:

- A uniform legal process for the financial sector regulators emphasising rule of law.
- A well-articulated principles-based approach to primary legislation emphasising a sound body of subordinate legislation based on these laws.
- Statutorily empowered, independent regulators with clear goals, powers and accountability.
- Removing twilight zones in the financial sector: every entity operating in the financial space needs to be on the radar of a financial regulator.
- Focusing on consumer protection - This is the ultimate objective of financial sector regulation as regulation per se is not an objective. Consumer protection has two components; prevention and cure. While financial regulators will address the former, the proposed financial redressal agency (FRA) spanning across the financial sector will deal with the latter addressing financial consumer grievances. A feed-back loop

from the FRA to the regulators will help the latter in systemically addressing consumer grievances by appropriate regulations.

- A resolution mechanism to address failure of financial firms and to protect consumers, including management of the deposit insurance scheme.
- Ownership neutrality and competition.
- Moving away from the sectoral approach to regulation.
- A framework for addressing systemic risk, financial sector development, coordination etc.

3. FSLRC REPORT – VOLUME I & II

Subsequent to the approach paper, the Financial Sector Legislative Reforms Commission headed by Chairman Justice B.N.Srikrishna submitted a two volume report to the Ministry of Finance in March 2013, with its recommendations on the legal and institutional framework for the future of India's financial system. The report was marked by four dissent notes by members P J Nayak, K J Udeshi, Y H Malegam and Jayanth R Varma. They have differed with the recommendations of the panel on different issues.

The main outcome of the Commission's work is a draft 'Indian Financial Code' which is non-sectoral in nature, which is in Volume II of the report and replaces the bulk of the existing financial law. Volume 1 expresses the arguments that led up to the key decisions embedded in the draft Code.

The Commission identified nine components of focus for financial law:

i. consumer protection,

ii. micro-prudential regulation,

iii. resolution,

iv. capital controls,

v. systemic risk,

vi. development and redistribution,

vii. monetary policy,

viii. public debt management and

ix. contracts trading & market abuse.

Under the proposed regulatory architecture, 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) would be merged into a new unified agency.

The Reserve Bank, however, will continue to exist with modified functions, said the two-volume report of the Commission.

It said the existing Securities Appellate Tribunal be subsumed into Financial Sector Appellate Tribunal (FSAT).

It also suggested that Financial Sector Development Council (FSDC) be given statutory framework.
The panel also suggested setting up of a new Debt Management Office (DMO) and also subsuming the existing Deposit Insurance and Credit Guarantee Corporation of India (DICGC) into the Resolution Corporation.

"The Commission believes that this proposed financial regulatory architecture is a modest step away from present practice, embeds important improvements, and will serve India well in coming years," the Commission said.

According to the Commission, the actual functioning of the regulator lies in three areas -- regulation-making, executive functions and administrative law functions.

With regard to capital control, the report said the Finance Ministry should make rules for inbound capital flows, while the onus of making rules for outbound capital flows should rest with the RBI.

"At present, in India, there is a confusing situation with regulators utilising many instruments such as regulations, guidelines, circulars, letters, notices and press releases. The draft Code requires all regulators to operate through a small number of well defined instruments only," it said. It said, in an emergency the regulator can issue regulations. However, these regulations would lapse within six months.

The Commission has proposed a financial regulatory architecture featuring seven agencies –

i. The existing RBI will continue to exist, though with modified functions.
ii. The existing SEBI, FMC, IRDA and PFRDA will be merged into a new unified agency.
iii. The existing Securities Appellate Tribunal (SAT) will be subsumed into the FSAT.
iv. The existing Deposit Insurance and Credit Guarantee Corporation of India (DICGC) will be subsumed into the Resolution Corporation.

v. A new Financial Redressal Agency (FRA) will be created.

vi. A new Debt Management Office will be created.

vii. The existing FSDC will continue to exist, though with modified functions and a statutory framework.

The Commission has recommended the repeal or large scale amendment of all special legislations that (a) establish statutory financial institutions; or (b) lay down specific provisions to govern any aspect of the operation or functioning of public sector financial institutions. The undertakings of all statutory institutions should be transferred to ordinary companies incorporated under the Companies Act, 1956 and their regulatory treatment should be identical as that applicable to all other financial companies. The following is a list of statutes that provide for the establishment of statutory financial institutions or contain special provisions to govern the operation and functioning of public sector financial institutions:

i. The State Financial Corporations Act, 1951:
Andhra Pradesh State Financial Corporation; Himachal Pradesh Financial Corporation; Madhya Pradesh Financial Corporation; North Eastern Development Finance Corporation; Rajasthan Finance Corporation; Tamil Nadu Industrial Investment Corporation Limited; Uttar Pradesh Financial Corporation; Delhi Financial Corporation; Gujarat State Financial Corporation; The Economic Development Corporation of Goa; Haryana Financial Corporation; Jammu& Kashmir State Financial Corporation; Karnataka State Financial Corporation; Kerala Financial Corporation; Maharashtra State Financial Corporation; Odisha State Financial Corporation; Punjab Financial Corporation; West Bengal Financial Corporation

ii. The State Bank of India Act, 1955

iii. The Life Insurance Corporation Act, 1956

iv. The State Bank of India (Subsidiary Banks) Act, 1959:
State Bank of Bikaner and Jaipur; State Bank of Indore; State Bank of Mysore; State Bank of Patiala; State Bank of Travancore; and State Bank of Hyderabad established under the State Bank of Hyderabad Act, 1956

v. The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970: Central Bank of India; Bank of India; Punjab National Bank; Bank of Baroda; UCO Bank; Canara Bank; United Bank of India; Dena Bank; Syndicate Bank; Union Bank of India; Allahabad Bank; Indian Bank; Bank of Maharashtra; and Indian Overseas Bank

vi. The General Insurance Business (Nationalisation) Act, 1972:
General Insurance Corporation of India; National Insurance Company Limited; New India Assurance Company Limited; Oriental Insurance Company Limited; and United India Insurance Company Limited

vii. The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980:
Andhra Bank; Corporation Bank; New Bank of India; Oriental Bank of Commerce; Punjab and Sind Bank; and Vijaya Bank

viii. The Export-Import Bank of India Act, 1981

ix. The National Bank for Agriculture and Rural Development Act, 1981

x. The National Housing Bank Act, 1987

xi. The Small Industries Development Bank of India Act, 1989

The five areas of disagreement within the Commission, which were expressed in four dissent notes, are as follows:

1. Authorisation requirements: Prof. Jayanth Varma expressed concerns about the authorisation requirements for financial service providers.

2. Capital controls: Mrs. K. J. Udeshi, Dr. P. J. Nayak and Mr. Y. H. Malegam disagreed with allocation of responsibilities on capital controls between the Ministry of Finance and RBI.

3. The role of the Ministry of Finance: Dr. P. J. Nayak disagreed with the role envisaged for the Ministry of Finance in draft Code especially the role of the FSDC.

4. Common-law tradition, principles-based law. Dr. P. J. Nayak expressed concerns about the strategy of the Commission that has favoured a common law, principles based approach.

5. Regulation of Non-Banking Financial Company (NBFC)s: Mr. Y. H. Malegam disagreed with the allocation of regulatory responsibilities for NBFCs.

4. INDIAN FINANCIAL CODE, 2013 – A SYNOPSIS

The draft Indian Financial Code submitted by the FSLRC contains 450 clauses under 15 Parts and 87 chapters with 6 schedules. It is a single unified and internally consistent draft law that replaces a large part of the existing Indian legal framework governing finance.

- The draft Code does not differentiate between different sectors in the financial system, the draft Code establishes a single framework for regulatory governance across all agencies.
- It creates a series of obligations for the Government and for regulators.
- The draft Code covers all functions of regulators, and defines the behaviour that is required from the regulator.
- It establishes certain elements of the functioning of board meetings, so as to ensure adequate oversight of the board over the organisation, and an emphasis on transparency.
- At present, in India, there is a confusing situation with regulators utilising many instruments such as regulations, guidelines, circulars, letters, notices and press releases. The draft Code requires all regulators to operate through a small number of well defined instruments only.
- The draft Code has specifics about each element of the executive powers. The first stage is the processing of permissions. A systematic process has been laid down through which permissions would be given.
- The draft Code has a systematic approach where certain standard categories are defined, and principles guide the application of penalties. This would help induce greater consistency, and help produce greater deterrence.
- A critical component of the framework for penalties is the mechanisms for compounding, which are laid on a sound foundation, and consistently applied across the entire financial system.
- It establishes certain basic rights for all financial consumers.

- The Commission envisages a unified Financial Sector Appellate Tribunal (FSAT) that would hear all appeals in finance. A considerable focus has been placed, in the draft Code, on the functioning of the registry of FSAT, so as to achieve high efficiency.
- The part on establishment of financial regulatory agencies provides for the creation of five new statutory bodies - UFA, Resolution Corporation, FRA, PDMA and FSAT. This part also provides for the allocation of regulatory responsibilities between the two financial sector regulators - UFA and RBI.
- The draft Code however revisits the functions and powers of RBI, and sets out the manner in which it must be operated and governed. Similarly, in case of FSDC, the existing FSDC is to be recast as a statutory body.
- The remaining provisions of the draft Code lay down the powers and functions of these statutory bodies and the principles and processes to govern the exercise of their powers.

The draft Code consists of the following fifteen Parts:

I. Preliminary
II. Establishment of financial regulatory agencies
III. Regulatory governance
IV. Financial consumer protection
V. Prudential regulation
VI. Contracts, trading and market abuse
VII. Resolution of financial service providers
VIII. Financial Stability and Development Council
IX. Development
X. Reserve Bank of India
XI. Capital controls
XII. Public Debt Management Agency
XIII. Investigations, enforcement actions and offences
XIV. Functions, powers and duties of the Tribunal
XV. Miscellaneous

5. DETAILED STUDY OF THE PROPOSED INDIAN FINANCIAL CODE

The Indian Financial Code is an Act to consolidate and amend the law regulating the Indian financial sector and to set out principles for financial regulation, and to provide for the establishment, objectives, powers of, and framework for interaction among, financial regulatory agencies, and for matters connected therewith or incidental thereto, with a view to bring coherence and efficacy in the financial regulatory framework.

It will extend to the whole of India.

IMPORTANT DEFINITIONS

There are about 160 definitions enumerated in the Code.

ESTABLISHMENT OF FINANCIAL REGULATORY AGENCIES – PART II OF THE DRAFT CODE

At present, India has a legacy financial regulatory architecture. The present work allocation, between RBI, SEBI, Insurance Regulatory and Development Authority (IRDA), Pension Fund Regulatory and Development Authority (PFRDA) and Forward Markets Commission (FMC), was not designed. It evolved over the years, with a sequence of piecemeal decisions responding to immediate pressures from time to time. The present arrangement has gaps where no regulator is in charge – such as the diverse kinds of ponzi schemes which periodically surface in India, which are regulated by none of the existing agencies. It also contains overlaps where conflicts between laws have consumed the energy of top economic policy makers. When there are overlaps, financial firms will undertake forum-shopping, where the most lenient regulator is chosen, and portray their activities as belonging to that favoured jurisdiction.

An approach of multiple sectoral regulators that construct 'silos' induces economic inefficiency. At present, many activities that naturally sit together in one financial firm are forcibly spread across multiple financial firms, in order to suit the contours of the Indian financial regulatory architecture. Financial regulatory architecture should be conducive to greater economies of scale and scope in the financial system. In addition, when the true activities a financial firm are split up across many entities, each of which has oversight of a different supervisor, no one supervisor has a full picture of the risks that are present.

When a regulator focuses on one sector, there are certain unique problems of public administration which tend to arise. Assisted by lobbying of financial firms, the regulator tends to share the aspirations of the regulated financial firms. These objectives often conflict with the core economic goals of financial regulation such as consumer protection and swift resolution.

The Commission has therefore proposed a financial regulatory architecture featuring seven agencies.

The Code envisages the establishment of the following agencies –

1) Unified Financial Authority (UFA)
2) Reserve Bank of India (RBI)
3) Financial Redress Agency (FRA)
4) Resolution Corporation
5) Financial Stability & Development Council (FSDC)
6) Public Debt Management Agency (PDMA)
7) Financial Sector Appellate Tribunal (FSAT)

Except for FSAT all the other regulatory agencies will be a body corporate having –

a) perpetual succession;
b) a common seal;
c) the power to sue and be sued;
d) the power to enter into and execute contracts;
e) the power to acquire, hold and dispose of property, both movable and immovable; and
f) the power to employ persons to discharge its duties.

All the regulatory agencies will have its head office at Mumbai, and it may establish offices at any other place in or outside India.

Unified Financial Authority (Chapter 3 of the Code)

The Financial Authority will be the Regulator for all financial services other than banking and payment systems.

The Financial Authority Board will consist of executive, non-executive and nominee members, to be appointed by the Central Government, where at all times –

a) the total number of members must not be more than twelve;
b) the total number of executive members must not be greater than half of the total number of members; and
c) up to two members will be nominee members.

The executive members will include the Financial Authority Chairperson and an administrative law member. The nominee members will be nominated by the Central Government. A senior officer of the Financial Authority will be appointed to act as the Secretary.

The members of the Financial Authority Board must be fit and proper persons having expertise in dealing with matters relating to finance, economics, law or public policy.

The general superintendence, direction and management of the affairs and business of the Financial Authority will vest in the Financial Authority Board, which may exercise all powers that may be exercised and do all acts that may be done by the Financial Authority.

The performance of the Financial Authority should be constantly reviewed by the Financial Authority Board to give effect to its objects, carry out its functions and utilise its resources.

Reserve Bank of India (Chapter 4 of the Code)

The Reserve Bank will be the Regulator for banking and payment systems.

The body corporate by the name of "Reserve Bank of India" established under Section 3 of the Reserve Bank of India Act, 1934 will continue as if it were established under the Code and will exercise the powers and carry out the functions designated to the Reserve Bank under the Code.

The Reserve Bank Board will consist of executive, non-executive and nominee members, to be appointed by the Central Government, where at all times –

a) the total number of members must not be more than twelve;
b) the total number of executive members must not be greater than half of the total number of members; and
c) up to two members will be nominee members.

The executive members will include the Reserve Bank Chairperson and an administrative law member. The nominee members will be nominated by the Central Government. A senior officer of the Reserve Bank will be appointed to act as the Secretary.

The members of the Reserve Bank Board must be fit and proper persons having expertise in dealing with matters relating to banking, payments and monetary policy. A person cannot be appointed as a member on the Reserve Bank Board if such person –

- is an employee of the Central Government, except in case of the nominee members;
- is a member of Parliament or a state legislature;
- is a director, employee or officer of any banking service provider;
- is a director, employee or officer of any system provider;
- is a member of an advisory council of the Reserve Bank; or
- is a member of the Monetary Policy Committee, other than –
    - the Reserve Bank Chairperson; or
    - the executive member designated by the Reserve Bank Board to serve on the Monetary Policy Committee

The general superintendence, direction and management of the affairs and business of the Reserve Bank, other than the formulation of monetary policy, will vest in the Reserve Bank Board, which may exercise all powers that may be exercised and do all acts that may be done by the Reserve Bank.

The performance of the Reserve Bank should be constantly reviewed by the Reserve Bank Board to give effect to its objects, carry out its functions and utilise its resources.

Financial Redress Agency

The Redress Agency Board will consist of executive, non-executive and nominee members, to be appointed by the Regulators, where at all times –

a) the total number of members must not be more than twelve;
b) the total number of executive members must not be greater than half of the total number of members; and
c) two members will be nominee members.

The executive members will include the Redress Agency Chairperson who will be appointed by the Regulators, in consultation with the Central Government. The nominee members will be nominated by the Regulators and will consist of one official from each of the Regulators. A senior officer of the Redress Agency will be appointed to act as the Secretary.

The members of the Redress Agency Board must be fit and proper persons having expertise in dealing with matters relating to consumer protection, including redress of consumer disputes.

The general superintendence, direction and management of the affairs and business of the Redress Agency will vest in the Redress Agency Board, which may exercise all powers that may be exercised and do all acts that may be done by the Redress Agency.

The performance of the Redress Agency should be constantly reviewed by the Financial Redress Agency Board to give effect to its objects, carry out its functions and utilise its resources.

Resolution Corporation

The Corporation Board will consist of executive, non-executive and nominee members, to be appointed by the Central Government, where at all times –

a) the total number of members must not be more than nine;
b) the total number of executive members must not be greater than half of the total number of members; and
c) three members will be nominee members.

The executive members will include the Corporation Chairperson and an administrative law member. The nominee members will consist of one nominee of the RBI, one from the Financial Authority and one nominated by the Central Government. A senior officer of the Corporation will be appointed to act as the Secretary.

The members of the Corporation Board must be fit and proper persons having expertise in dealing with matters relating to the regulation, supervision, or resolution of financial service providers.

The general superintendence, direction and management of the affairs and business of the Corporation will vest in the Corporation Board, which may exercise all powers that may be exercised and do all acts that may be done by the Corporation.

The performance of the Corporation should be constantly reviewed by the Corporation Board to give effect to its objects, carry out its functions and utilise its resources.

Financial Stability & Development Council (FSDC)

The Council Board will consist of the following executive and nominee members –

a) two executive members;
b) four nominee members.

The executive members will consist of the Council Chief Executive and an administrative law member. The nominee members will consist of the Minister of Finance, as a nominee of the Central Government; the Reserve Bank Chairperson, as a nominee of the Reserve Bank; the Financial Authority Chairperson, as a nominee of the Financial Authority and the Corporation Chairperson, as a nominee of the Corporation. The nominee of the Central Government will be the

Council Chairperson. A senior officer of the Council will be appointed to act as the Secretary.

The general superintendence, direction and management of the affairs and business of the Council will vest in the Executive Committee of the Council, which may exercise all powers that may be exercised and do all acts that may be done by the Council.

All references in the Code to the Council Board, or the board of a Financial Agency, where relevant to the Council, will be read as references to the Executive Committee. Whereas references to the Council or to the Council Board in Clauses 291, 301, 302, and 305 of the Code will be read as references to the Council Board.

Where there is any disagreement, or lack of consensus in the Executive Committee regarding any proposed decision or proposed action of the Executive Committee, the Executive Committee must request the Council Board to make a decision regarding such proposed decision or proposed action.

The Council Chief Executive must be a fit and proper person, having expertise on matters relating to systemic risk.

The performance of the Council should be constantly reviewed by the Executive Committee to give effect to its objects, carry out its functions and utilise its resources.

Public Debt Management Agency (PDMA)

The Board of the Debt Agency also known as the Debt Agency Management Committee will consist of executive, non-executive and nominee members, to be appointed by the Central Government, where at all times –

a) the total number of members must not be more than eight;

b) the total number of executive members must not be greater than half of the total number of members; and

c) at least two members will be nominee members from the above.

The executive members will include the Debt Agency Chief Executive, who will also be the chairperson of the Debt Agency Management Committee. The nominee members will consist of a nominee of the Central Government, a nominee of the RBI and if the Debt Agency borrows on behalf of more than one State Governments, one nominee on behalf of all such State Governments. The nominee members under clause (c) will - if the Debt Agency borrows on behalf of one State Government, be appointed in accordance with rules made by the Central Government; or if the Debt Agency borrows on behalf of one or more State Governments, be appointed by rotation from such State Governments, and in accordance with rules made by the Central Government.

The Debt Agency Management Committee will appoint a senior officer of the Debt Agency to act as its secretary.

The members of the Debt Agency Management Committee must be fit and proper persons having expertise in dealing with matters relating to public debt, public finance or financial markets.

The general superintendence, direction and management of the affairs and business of the Debt Agency will vest in the Debt Agency Management Committee, which may exercise all powers that may be exercised and do all acts that may be done by the Debt Agency Management Committee.

The performance of the Debt Agency should be constantly reviewed by the Debt Agency Management Committee to give effect to its objects, carry out its functions and utilise its resources.

Financial Sector Appellate Tribunal (FSAT)

The Tribunal will have its main bench at Mumbai and may establish benches at any other place in India.

The Tribunal will consist of the Presiding Officer and at least two other members. The Central Government may notify a higher number of members of the Tribunal in consultation with the Presiding Officer.

The Presiding Officer and all members of the Tribunal will be appointed by the Central Government in accordance with the provisions of Chapter 83. Chapter 83 of the Code deals with qualifications, selection, conditions of service, resignation and removal of Presiding officers and members.

In the event of a temporary vacancy in the office of the Presiding Officer, the Central Government may nominate one of the members of the Tribunal as an officiating Presiding Officer for a period not exceeding 180 days, having regard to suitability for effective oversight and administration of the Tribunal's adjudicating functions.

REGULATORY GOVERNANCE - PART III OF THE DRAFT CODE

Government agencies are required to perform complex functions in eight areas in finance: consumer protection, micro-prudential regulation, resolution of failing financial firms, capital controls, systemic risk, development, monetary policy and debt management. For these functions to be appropriately performed, well structured Government agencies are required. This is sought to be achieved through a specialised and consolidated set of provisions on regulatory governance in the draft Code.

The requirements of independence and accountability of financial regulators are the same across the financial system and hence the Commission recommended a unified set of provisions on financial regulatory governance for all areas of finance.

The objective of the proposed Code on regulatory governance is to create a series of obligations for the Government and for regulators. The Code covers all functions of the regulator and lays down the principles and standards of behaviour expected from the regulator. It also provides for a system of monitoring the functions of the regulator with a process to ensure that the regulator is fully transparent and they act in compliance with the best practices of public administration.

The Commission felt that the structure of the regulator should be standardised for all financial regulators except for certain exemptions where the general regulatory processes may not apply. These exceptions to the general process law should be kept to the minimum and generally avoided.

Selection of certain members of the board of a Financial Agency

Except for nominee members, all members of the board of a Financial Agency should be appointed by the Central Government from a list of persons shortlisted by a selection committee. The selection committee must be constituted by the Central Government in accordance with the First Schedule of the Code. The First Schedule lays down the constitution of the selection committee and the procedure to be followed by the selection committee.

In case of any vacancy in the board of a Financial Agency, the selection committee should not consider any person –

- who has been appointed twice as a member of the board of that Financial Agency;
- who has served as the chairperson of any Financial Agency;
- whose age would not permit such person to serve a term of at least three years; or
- who is a non-executive member of any Financial Agency, for the position of non-executive member.

The selection committee should consider the following principles when selecting persons –

a) merit;
b) independence;
c) balance of the board; and
d) conflict of interest.

If any vacancy in the board of a Financial Agency is not filled within a period of 180 days from the date such vacancy arises, the Central Government should make a report on the reasons for the delay in the appointment within 90 days from the date on which the period of 180 days expires, and lay such report before both Houses of Parliament.

Executive members of the board of a Financial Agency should contribute their entire time to the oversight and management of the Financial Agency. The board of a Financial Agency can permit, by writing, executive members to undertake such honorary work, if it is not likely to interfere with their duty as executive members.

Rules will be made by the Central Government to govern the nomination of persons as nominee members to the board of a Financial Agency by giving due regard to the qualifications, experience, past achievement and reputation of such persons.

The administrative law member as a member of the board of a Financial Agency will be responsible for –

a) the assessment and review of the performance of administrative law officers of that Financial Agency;

b) the review of decisions taken by administrative law officers of that Financial Agency under Clause 403; (Clause 403 deals with procedure for review of decision orders)
c) other functions as provided under the Code.

The administrative law member must ensure that the allocation of duties, review of performance, and general service conditions of administrative law of officers is carried out in a manner which maintains their independence and accountability. The administrative law member should not be involved in any functions of the Financial Agency that conflict with the independence and neutrality of such member.

The above mentioned provisions will not apply to the Redress Agency or the Debt Agency.

Meetings of the board of a Financial Agency

The meetings of the board of a Financial Agency should be held in compliance with the requirements of the Second Schedule of the Code.

The board of the Financial Agency must make bye-laws to govern the proceedings of its meetings. The bye-laws governing the proceedings of the meetings of the board of the Financial Agency should be consistent with the best practices of governance and transparency for deliberative bodies.

The procedure of meetings of the Board of the Financial Agency as mentioned under the Second Schedule of the Indian Financial Code is as follows –

1) The board of a Financial Agency must meet as frequently, and at such place, as may be provided for by bye-laws.
2) The members may attend meetings of the board of a Financial Agency using mechanisms that allow members to participate in the meetings from remote locations without being physically present.
3) The quorum of a meeting of the board of a Financial Agency will be more than half of the number of members appointed to the board of the Financial Agency.
4) The chairperson of a board must convene a meeting within reasonable time, if two or more members of the board of the Financial Agency make a request in writing.
5) If the chairperson fails to convene a meeting within 30 days of a request in writing, the members may convene a meeting without the chairperson.
6) Each member of the board of the Financial Agency must be given at least 7 days notice of a meeting, unless the circumstances require the meeting to be convened with shorter notice.

7) The chairperson of the Financial Agency will chair the meetings of the board of the Financial Agency.
8) If the chairperson of the Financial Agency is not present at a meeting, the person who has served as member for the longest period of time will chair the meeting, unless otherwise specified.
9) The secretary of the board of the Financial Agency will be responsible for keeping the records of every meeting of the board of the Financial Agency.
10) The records will be published by the Financial Agency within three weeks of each meeting. Selected portions of records may not be published if such portions meet any of the following conditions –
    a. they relate exclusively to functions of individuals within the Financial Agency;
    b. they relate to information that has been obtained from a person in confidence, where such information is exempt from disclosure by that person under the Right to Information Act, 2005 (22 of 2005);
    c. they involve discussion of a particular instance of violation of laws or censuring any person;
    d. they disclose information about a particular investigation which is ongoing;
    e. they disclose techniques and procedures for investigation or inspection;
    f. they disclose information of a commercial nature relating to a financial service provider which has been obtained for regulatory purposes; or
    g. they deprive a person of a right to a fair and impartial adjudication.
11) The selected portions of records may be published with appropriate delay if such portions meet any of the following conditions –
    a. they are likely to lead to major instability in the financial system;
    b. they are likely to significantly frustrate implementation of an action proposed by the Financial Agency or its board, where such action has not been disclosed to the public; or
    c. they involve discussion of any particular legal proceeding before a tribunal, court or arbitrator.
12) The publication of records relating to a particular meeting, may be delayed or prevented only if the board of the Financial Agency, in such meeting –

a. records the reason under items (*11*) or (*12*) above, applicable in respect of each portion of the records;
b. the majority of members present at the meeting, vote in favour of such action for each portion of the records separately; and
c. the vote of each member is recorded and published in accordance with item (*10*) above

13) Portions of records delayed for publication must be published by the Financial Agency within six months, or as soon as the reasons for their delay cease to be applicable, whichever is earlier. “Records” means the agenda, proposals, and decisions taken at the meeting, and includes the votes of each member of the Financial Agency.

Decisions of the Board of a Financial Agency

The board of every Financial Agency should discharge its duties by taking decisions through a majority vote of the members present at a meeting of the board of the Financial Agency. Each member of the board of a Financial Agency will have one vote. If there is an equality of votes, the person chairing the meeting will, unless otherwise provided, have a casting vote. The board of a Financial Agency must make bye-laws to provide for the process of making decisions without the physical presence of the members of the board of the Financial Agency.

Conduct of members of the board of a Financial Agency

Members of the board of a Financial Agency should, at all times, act honestly, and use reasonable diligence in the discharge of their duties. Any member who has any direct or indirect interest in any matter coming up for the consideration at a meeting of the board of a Financial Agency should, as soon as possible after relevant circumstances have come to that member’s knowledge, disclose the nature of interest at such meeting. A disclosure made by a member of the board of a Financial Agency will be recorded in the proceedings of the meeting of the board of the Financial Agency, and such member must recuse from any deliberation or decision of the board of the Financial Agency with respect to that matter.

Validity of proceedings

No act or proceeding of the board of a Financial Agency will become invalid merely by reason of –

(*a*) any vacancy in, or any defect in the constitution of, the board of the Financial Agency;
(*b*) any defect in the appointment of a person as a member; or
(*c*) any procedural irregularity not affecting the merits of the case.

Conditions of service of members of the board of a Financial Agency

Members of the board of a Financial Agency can hold office for a term of 5 years or until the age of retirement whichever is earlier. The age of retirement for executive members and nominee members will be the same as that for a Secretary to the Central Government.

The Central Government must make rules governing the terms of appointment of members of the board including salary; leave; medical benefits; and any other aspect of employment.

When making rules the Central Government should consider the requirements of maintaining independence of the board of the Financial Agency and attracting requisite talent and expertise to the board of the Financial Agency.

The terms of appointment of any existing chairperson or member must not be varied, to their disadvantage, after their appointment. The Central Government may make separate rules governing the terms of appointment for – non-executive members; nominee members; executive members; and executive members acting as chairpersons.

Nominee members will serve on the board of a Financial Agency at the pleasure of the person nominating such member.

Resignation

Any member of the board of a Financial Agency can resign by giving a signed notice of resignation to the Central Government. A member, after providing a notice of resignation, will continue to hold office

until the earlier of –

a) the date the Central Government appoints a person to the post vacated by such resignation; or
b) the expiry of 90 days from the date the notice of resignation was provided to the Central Government.

In relation to the Council Board, this provision will apply only to the Council Chief Executive and the administrative law member of the Council Board.

Removal of members

A member of the board of a Financial Agency can be removed from office if such member has –

a) been adjudged to be insolvent;
b) been sentenced to imprisonment for 180 days or more;
c) been convicted of an offence involving moral turpitude;
d) engaged in any employment during the tenure of appointment, in violation of the terms and conditions of service;
e) acquired any financial or other interest contrary to their terms and conditions of service that is likely to prejudice their functions;
f) failed to adequately disclose any direct or indirect pecuniary interest under Clause 36(*2*); (clause 36(2) deals with the disclosure by any member, of any direct or indirect interest in any matter coming up for consideration at a meeting of the board of a financial agency)
g) made any material misrepresentation to the selection committee;
h) abused their position so as to render their continuance in office prejudicial to the objectives of that Financial Agency; or
i) has become physically or mentally incapable of discharging their duties.

A member of the board of a Financial Agency may not be removed from office unless –

a) such member has been given a reasonable opportunity of being heard; and
b) a notification is made 40

If the Central Government proposes to remove a member of the board of a Financial Agency on any grounds mentioned above, the Central Government should follow the following procedure –

a) the Central Government must establish a committee, chaired by a nominee of the Chief Justice of India, to inquire if the grounds for removal have been met;
b) the committee must have at least one retired judge of a High Court;
c) the committee must inform the Central Government, in writing, whether one or more grounds for removal has been met; and
d) if the committee has informed the Central Government that one or more grounds for removal has been met, then the Central Government must remove such member by publishing a notification in this regard.

A notification in this regard must contain –

a) the grounds for the removal of such member; and
b) the facts that were considered by the Central Government to arrive at its decision.

The member of the board of the Financial Agency will cease to hold office from the date of the notification.

Casual vacancy

If a vacancy arises on the board of a Financial Agency for any reason other than resignation or removal, the chairperson of the Financial Agency must immediately inform the Central Government. The Central Government may appoint any person on the board of a Financial Agency to fill the vacancy on a temporary basis for a period not exceeding 180 days, or until a person is appointed or nominated as the case may be, whichever is earlier.

Review Committee

The members of the board of a Financial Agency must appoint at least two non-executive members from the board of the Financial Agency to constitute a review committee to review whether –

a) the Financial Agency is in compliance with applicable laws;
b) the bye-laws of the board of the Financial Agency promote transparency and best practices of governance;
c) the Financial Agency is in compliance with the decisions of the board of the Financial Agency; and
d) the Financial Agency is managing risks to its functioning in a reasonable manner.

No member of the review committee may serve continuously for more than 5 years on such committee. These provisions will not be in derogation of the general powers of the board of the Financial Agency to constitute committees for other functions.

The review committee must maintain a system by which any person may communicate to the review committee, any incidence of –

a) violation of laws by the Financial Agency;
b) theft or misappropriation of resources of the Financial Agency by any person;
c) abuse of powers of the Financial Agency by any officer, employee or agent within the Financial Agency; or

d) violation of any decision of the board of the Financial Agency by any officer, employee or agent of the Financial Agency.

The board of the Financial Agency should make bye-laws governing information to be provided to the review committee.

The review committee should make a report, at least once every financial year, of its findings to the board of the Financial Agency and the report will be attached with the annual report of the Financial Agency.

Administrative powers and assignment of functions

Unless provided otherwise, the board of a Financial Agency may, by order in writing, allocate functions of the Financial Agency under the Code to the chairperson of the Financial Agency or any other member or officer or employee of the Financial Agency, subject to any conditions that may be provided in the order. Unless provided otherwise, the chairperson of a Financial Agency is the chief executive officer of the Financial Agency having powers of the general superintendence, direction and control in respect of all administrative matters of that Financial Agency.

Officers and employees of a Financial Agency

A Financial Agency may appoint such officers and employees as are necessary for the efficient discharge of its functions. The Financial Agency must make bye-laws to determine the procedure of selection, terms, compensation and conditions of the appointment and service of persons appointed.

Each Financial Agency should designate an appropriate number of employees as administrative law officers exclusively. Each Financial Agency must ensure the independence and neutrality of administrative law officers by making bye-laws governing the terms of appointment of administrative law officers. The performance of the administrative law officer will only be appraised by the administrative law member of the board of the Financial Agency. These provisions will not apply to the Redress Agency or the Debt Agency.

<u>Advisory Councils to advise the board of a Financial Agency (Chapter 12 of the Code)</u>

The board of a Financial Agency may set up advisory councils to advise the board with regard to any of the following –

a) sectors of the financial system which require particular skill, information or expertise;
b) specified classes of financial service providers regulated by the Financial Agency; or
c) any other matter as the board of the Financial Agency may require.

The board of the Financial Agency must set up advisory councils if either of the following conditions is met –

a) the Code or any other law enforced by the Financial Agency requires an advisory council to be constituted; or
b) the board of the Financial Agency finds that it is expedient, necessary or relevant for the discharge of its functions to set up such advisory council.

Each advisory council must comprise experts in the issues for which the advisory council has been constituted. No expert will serve as a member of an advisory council for a period longer than ten years.

The functions of an advisory council will include –

a) making representations to the board of the Financial Agency, in the formof advice, comments or recommendations, on the policies and practices of the Financial Agency;
b) preparing and submitting reports advising the board of the Financial Agency on all draft regulations, prior to the expiry of the period for receiving comments from the public on such draft regulations;
c) interacting with financial service providers and the public, as may be necessary to discharge its functions;
d) on the request of any member of the board of the Financial Agency, providing advice to the board of the Financial Agency on any matter; and
e) any other matter related to areas for which it has been constituted.

The functions mentioned above will be limited to the issues for which the advisory council was constituted. The advisory council will discharge its functions by making reports to the board of the Financial Agency.

The Financial Agency must publish all reports received from the advisory council in accordance with the following –

a) reports under clause (*b*) above must be published with the regulations; and
b) all other reports must be published within a period of 180 days of being submitted to the board of the Financial Agency.

The board of the Financial Agency must make bye-laws governing the functioning of advisory councils. The bye-laws should include –

a) the process of selecting experts to be members of advisory councils;
b) the resources to be allocated to the advisory councils to discharge their functions;
c) the terms, compensation and conditions of appointment of members of the advisory council; and
d) any other provision required for the efficient functioning of the advisory council.

<u>Regulations and Guidance (Chapter 13 of the Code)</u>

A Financial Agency can, by notification, make regulations, where required, consistent with the Code and any rules made there under to carry out the purposes of the Code.

Process of making regulations

If a Financial Agency proposes to make any regulations, it must, acting through its board, publish a draft of the proposed regulations. Every draft of the proposed regulations which is published must be accompanied by a statement setting out –

a. the objectives of the proposed regulations;
b. the problem that the proposed regulations seeks to address;
c. the underlying principles under the Code, relevant to the proposed regulations, and the expected outcome of the proposed regulations;
d. how the draft regulations fulfil the provision of this Act under which the regulations are made;
e. an analysis of costs and an analysis of benefits of the proposed regulations; and
f. the process by which any person may make a representation in relation to the proposed regulations.

If the Financial Agency prefers one principle over any other it must issue a statement of reasons for such preference with the proposed regulations. Before making the regulations, the Financial Agency must have regard to any representations made to it.

To make the regulations –

a) the board of the Financial Agency should approve the regulations; and
b) the Financial Agency must publish –
    a. all the representations received by it; and
    b. unless specified otherwise, at least a general account of the response of the Financial Agency to the representations.

If the regulations substantially differ from the proposed regulations published by the Financial Agency, the Financial Agency, must publish –

a. the details and reasons for such difference; and
b. an analysis of costs and an analysis of benefits of the differing provisions.

Emergency regulation making

A Financial Agency can dispense with the procedure mentioned above, if the time taken to comply with such provision has the potential to cause considerable losses for consumers or financial service providers. If a Financial Agency makes regulations under this section, it must – publish the reasons for invoking this provision and submit a report to the Central Government within reasonable time.

The regulations must be accompanied by the statement giving details of the objectives of the proposed regulations, the problem that the proposed regulations seeks to address, the underlying principles and how the draft regulations will fulfil the provision of this Act under which the regulations are made. Regulations made under this provision will cease to have effect after a period of 180 days from the date on which the regulations are notified.

Except for emergency regulations, all regulations made by a Financial Agency must apply from an identified prospective date that is set out in such regulations, with due regard to the time necessary for persons impacted to arrange to comply with such regulations.

Standard of analysis of costs and analysis of benefits

When carrying out an analysis of costs and an analysis of benefits, the Financial Agency must consider the probable costs that will be borne by –

(*a*) financial service providers in complying with the regulations;

(*b*) consumers, both directly and indirectly;

(*c*) the Financial Agency in enforcing the regulations; and

(*d*) any other persons affected by the regulations.

The Financial Agency must consider the probable benefits that will accrue to the consumers and other persons as a result of the regulations.

The Financial Agency must use –

(*a*) the best available data, and wherever not available, reasonable estimates, to carry out the analysis; and

(*b*) the best scientific method available to carry out the analysis when data is available to the Financial Agency.

General Guidance

A Financial Agency may publish general guidance with respect to –

a) the operation of the Code and any regulations made under it;
b) any matters relating to functions of the Financial Agency;
c) meeting the objectives of the Financial Agency; or
d) any other matter about which the Financial Agency finds it appropriate to provide information or advice.

All requirements of Clause 52 i.e. process of making regulations will apply to the process of making general guidance, except the requirements of analysis of costs and analysis of benefits.

Violations of general guidance alone will not amount to violation of any provision of law or regulation enforced by the Financial Agency. A general guidance issued under this Code will be binding on the Financial Agency. The Financial Agency may withdraw or amend any general guidance issued by it at any time for reasons to be recorded in writing and published.

Special Guidance

Any person may make an application to a Financial Agency seeking Special guidance on transactions or activities governed by the Code. The special guidance will be limited to the interpretation or applicability of laws or regulations enforced by the Financial Agency. The Financial Agency may specify the manner in which it may charge fees proportional to the cost of providing special guidance.

The Financial Agency may require the person seeking the special guidance to provide information relevant to the issue or transaction for which the special guidance is sought.

The Financial Agency must publish the application and special guidance provided by it. If the information provided by the person seeking special guidance, or if the nature of the special guidance is commercially sensitive, and the applicant makes a request to such effect, the Financial Agency may decide – not to publish an application or special guidance for until such time the information remains commercially sensitive, subject to a maximum period of two years; or to withhold the identities of applicants or parties involved.

No person has recourse to the Tribunal –

a) against the refusal of the Financial Agency to provide special guidance; or
b) against the special guidance provided by the Financial Agency.

Violation of a special guidance alone will not constitute violation of any laws or regulations enforced by the Financial Agency. A special guidance issued by a Financial Agency will be binding on such Financial Agency.

Review by the Tribunal

Any person aggrieved by any regulations or general guidance issued by the Financial Agency may prefer an appeal to the Tribunal on the ground of being contrary to the Code, including that –

a) they were made without complying with the requirements of this Part;
b) they exceeded the limits of the provision under which they were made;
c) in the case of regulations, there was a material and substantial error in the analysis of costs or the analysis of benefits;
d) the conditions under emergency regulation did not exist for regulations made under that clause;
e) the regulations were in gross disregard of the principles that Financial Agency was required to follow while making the relevant regulations; or
f) the substantial provisions of the regulations did not address the stated objects of the regulations.

The Tribunal must set aside the regulations or general guidance if it determines that any of the grounds mentioned above are met.

Review of regulations

All regulations made under the Code must be reviewed by the Financial Agency within 3 years of such regulations being issued. The review must consist of –

a) an analysis of costs and an analysis of benefits of the regulations;
b) an analysis of all interpretations of the regulations made by the Financial Agency, the Tribunal, any High Court or the Supreme Court; and
c) an analysis of the applicability of the regulations to any changes in circumstances since such regulation was issued.

Every review should be tabled before the board of the Financial Agency as soon as possible. The Financial Agency must publish the review within 120 days of being tabled before the board of the Financial Agency.

Bye-laws

All proposals for making bye-laws by a Financial Agency, should be submitted to the chairperson of the Financial Agency. On receipt of a proposal, the chairperson must introduce the proposal in the form of an agenda in the next meeting of the board of the Financial Agency. If the board of the Financial Agency approves the proposal in principle, the draft bye-laws must be made available to the public for comments for a period of 30 days.

The draft bye-laws must clearly state –

a) the provisions of the Act under which it is proposed to be issued;
b) its objectives; and
c) the issue it seeks to address.

The Financial Agency must publish all the comments received on the draft byelaws and consider them before publishing the final bye-laws.

The above mentioned procedure need not be adhered to by a Financial Agency in making bye-laws if circumstances so require. The existence and details of such circumstances must be set out in writing by the Financial Agency and published. Bye-laws made in cases of exigency will remain in force for a period as may be identified by the Financial Agency, which may not exceed 180 days.

Process for making rules

The Central Government may, by notification, make rules where required for carrying out the purposes of the Code. The draft rules must be made available to the public for comment for thirty days. All comments received from the public must be published and considered by the Central Government before notifying the rules. If no date is identified in the notification of the rules, they will come into effect from the date of their publication.

Regulations, bye-laws and rules to be laid before Parliament

All regulations and all bye-laws made by a Financial Agency and all rules made by the Central Government must be laid before each House of Parliament for a period of thirty days starting from the day on which the regulations, bye-laws, or rules are issued. In calculating the thirty day period, no account is to be taken of any time during which Parliament is dissolved or prorogued or during which both Houses are adjourned for more than four days. The regulations, bye-laws, or rules, will be deemed to be approved by Parliament at the expiry of the thirty day period unless, before the end of that period, both Houses of Parliament agree that the regulations, bye-laws or rules – (*a*) should not be made, in which case the regulations, bye-laws or rules will be of no effect; or (*b*) should be made with certain modifications, in which case the regulations, bye-laws or rules will come into effect in the modified form. The annulment or modification of the regulations, bye-laws or rules by Parliament will not affect the validity of anything already done under the regulations, bye-laws or rules.

Joint Action by Financial Agencies

A Financial Agency must refer a matter to the Council, if the Financial Agency is unable to arrive at an agreement with another Financial Agency; within 180 days of commencing the process on any issue that requires such Financial Agencies to –

a) issue joint regulations under the Code; or
b) agree on any action required to be taken under the Code.

Co-ordination between Financial Agencies

Each Financial Agency must enter into a memorandum of understanding with each Financial Agency in respect of obligations under the Code to co-ordinate with one another or to undertake joint action. The memorandum of understanding should relate to –

a) co-operation in making regulations, including joint regulations;
b) co-operation for harmonising regulations governing similar matters;
c) access to and sharing of information;

d) cross-staffing of employees; or
e) consultation regarding any important changes that may have been proposed by any party to the memorandum of understanding.

Every Financial Agency should publish a report of compliance in this regard in its annual report.

<u>Disposal of Applications (Chapter 14 of the Code)</u>

All application required to made to a Financial Agency under the Code must be in accordance with Chapter 14 of the Code i.e. Clauses 67 to 71.

The Financial Agency should acknowledge the receipt of all applications, whether complete or not, within thirty days from receipt. An applicant can, at any time, before the Financial Agency conveys its decision, by a second application to the Financial Agency – modify an existing application; or withdraw an application for variation and re-apply. If an applicant withdraws an application for variation and re-applies, the Financial Agency must process the application afresh. If required, the financial agency can request for additional information from the applicant and state the relevance of the additional information so sought.

If an application received by a Financial Agency is incomplete, the Financial Agency must inform the applicant in this regard within 30 days from the date of the receipt of the application. The Financial Agency must decide all applications in accordance with the provisions and regulations governing the matter to which the application pertains. The Financial Agency must not reject any application merely on the grounds that no regulations governing the subject matter of the application are in effect. The Financial Agency must ensure that all applications are determined within a period of 180 days from the date the application was received by the Financial Agency. If the Financial Agency does not reject an application within one hundred and eighty days from the date such application has been made, then that application will be deemed to have been accepted. The above mentioned period may be extended by the Tribunal on an application by the Financial Agency. If the Financial Agency proposes to reject an application, it must issue a show cause notice to the applicant. If the Financial Agency decides to reject an application, it must issue a decision order to the applicant. If the Financial Agency decides to accept an application, it must inform the applicant by issuing an approval order. The approval order, consistent with applicable regulations, must state – (*a*) the scope of approval; (*b*) the time-period for which the approval is effective; (*c*) the provisions under which the approval is granted; and (*d*) any conditions, limitations or requirements subject to which the approval is granted.

If a Financial Agency proposes to cancel any permission or approval granted in pursuance of an application otherwise than at the request of the person who made the application, then it must issue a show cause notice to such person. If the Financial Agency decides to cancel any permission or approval granted in pursuance of an application other than the request of the person who made the application, then it must give issue a decision order to such person.

<u>Information and Inspection (Chapter 15 of the Code)</u>

The Financial Agency may make regulations requiring financial service providers to make reports in a particular form, manner and frequency. The Financial Agency may, by notice in writing given to any financial service provider, its financial representatives or related persons, require such person –

(*a*) to provide specified information; or

(*b*) to produce specified documents.

The information or documents requested by the Financial Agency must be provided or produced –

(*a*) before the end of such reasonable period as may be specified;

(*b*) at such place as may be specified; and

(*c*) in such form or manner as may be specified.

The Financial Agency may require – any information provided, whether in a document or otherwise, to be verified in such manner, or any document produced to be authenticated in such manner, as it may reasonably require.

A Financial Agency may carry out inspection of financial service providers at regular intervals. The Financial Agency should record documents inspected and the finding of such inspections in a specified form. The Financial Agency will publish regulations governing –

(*a*) the intervals at which a financial service provider may be inspected;

(*b*) notice of inspection by the Financial Agency;

(*c*) the steps the financial service provider has to carry out to enable the inspection; and

(*d*) such other conditions as to enable the Financial Agency to collect accurate information about the financial service provider.

The regulations must balance the requirement of the Financial Agency with the requirement to prevent disruption in the business of financial service providers or impose unreasonable burden upon financial service providers.

Functioning of the Financial Agency (Chapter 16 of the Code)

Minimum standard for publication of information

A Financial Agency must maintain a website or any other universally accessible repository of electronic information to –

a) record and publish all information that the Financial Agency is obligated to record or publish;
b) provide a copy of all rules, regulations, bye-laws enforced and all guidance issued by the Financial Agency, including all amendments to such rules, regulations, bye-laws and guidance;
c) provide information about the process and manner in which applications under the Code are to be made; and
d) provide material information about the functions of the Financial Agency.

All information published on the website or other repository of the Financial Agency must be in an easily accessible and text-searchable format. The board of the Financial Agency must review the quality of the website or other repository, based on international best practices, at least once every 3 years. The board of the Financial Agency must publish the findings of the review with the annual report of the Financial Agency. The Financial Agency may make regulations supplementing the requirements of this provision. Any information not recorded or published on the website or other repository of the Financial Agency will be presumed to not have been recorded or published for the purposes of the Code.

Allocation and use of resources by a Financial Agency

Each Financial Agency must prepare a report of expenditure with respect to each of its duties and objectives for each financial year. Each Financial Agency must maintain a transparent system of allocation of resources to carry out its duties and meet its objectives as stated in its report of expenditure. The Central Government may make rules requiring the Financial Agency to make additional reports of its expenditure. At least once every 3 years, the board of the Financial Agency must review the quality of the report of the Financial Agency with the requirements of this provision. The reports should be published with the annual report of the Financial Agency.

Performance and efficiency of a Financial Agency

If any law requires the Financial Agency to carry out any function, the Financial Agency must develop a system to measure the efficiency with which that function was discharged. The Financial Agency must measure its efficiency in relation to its functions, in accordance with the system developed above, in a reasonable and objective manner, for each financial year. The Financial Agency must determine goals for the discharge of each function for which it has developed a system for the financial year.

The Financial Agency must, at the end of each financial year, prepare a report comparing information from above with the goals that were set for the financial year.

The Central Government may make rules requiring the Financial Agency to make additional reports of its performance and discharge of functions.

At least once every three years, the board of the Financial Agency must review the quality of the report of the Financial Agency with the requirements of this provision. The reports must be published with the annual report of the Financial Agency.

"Reasonable and objective manner", in relation to the measurement of a system, includes –

(*a*) a system of measurement that best represents any function being measured;

(*b*) a standardised system that allows comparison where possible; and

(*c*) where possible, numerical systems of measurement.

Returns and reports

Each Financial Agency must furnish to the Central Government, at such time and in such manner and form as may be prescribed, or as the Central Government may direct, such returns and statements, and such particulars in regard to any proposed or existing operations of the Council as the Central Government may, from time to time, require. The board of the Financial Agency must prepare and submit to the Central Government an annual report within 90 days from the end of a financial year. The annual report must be in such manner and form as may be prescribed, and must give a true and full account of the performance of the Financial Agency in the previous financial year, including –

a) a review of the Financial Agency's activities in relation to the discharge of its functions and the achievement of its objectives;

b) all information that is necessary to understand the discharge of functions and the achievement of the objectives of the Financial Agency, that has been published by the Financial Agency;
c) all information that the Financial Agency is required to publish along with the annual report under the Code;
d) a statement of the deliberations of the Financial Agency, accompanied by the records of meetings of the Financial Agency;
e) a statement indicating any statutory obligation that the Financial Agency or the board of the Financial Agency has not complied with, and reasons for such non-compliance;
f) a statement by the chairperson of the Financial Agency, in relation to the activities and performance of the Financial Agency;
g) a statement of major activities the Financial Agency will undertake in the subsequent financial year; and
h) a statement which any member of the board may wish to include.

A copy of the annual report so received should be laid, as soon as possible after its receipt, before each House of Parliament.

Accounts and Audit

Each Financial Agency must maintain proper accounts and other relevant records and prepare an annual statement of accounts, in such form as may be prescribed by the Central Government in consultation with the Comptroller and Auditor-General of India. The accounts of a Financial Agency must be audited annually by the government auditor. The audit by the government auditor will not include an audit of performance of the Financial Agency. The government auditor must –

a) certify the accounts of the Financial Agency; and
b) make an audit report.

The certified accounts and the audit report must be placed before the board of the Financial Agency and the board of the Financial Agency must record its observations on the audit report. The annual report of the Financial Agency must include –

(*a*) certified accounts and audit report and

(*b*) the observations of the board of the Financial Agency.

In relation to maintaining proper accounts and other relevant records, the Reserve Bank, while preparing its financial statements, must comply with accounting standards to the extent that it is, in the opinion of the Reserve Bank Board, appropriate to do so, having regard to the objects and functions of the Reserve Bank.

In relation to the audit of the accounts of the Reserve Bank, the government auditor, will not audit –

a) the deliberations, decisions or minutes of the Monetary Policy Committee under clause 335, and the actions of the Reserve Bank under clause 343 of the Code in relation to implementing monetary policy decisions;
b) the transactions by the Reserve Bank under clauses 345 and 346; and
c) any part of a discussion or communication between members of the Reserve Bank Board, members of the Monetary Policy Committee, and officers and employees of the Reserve Bank related to clauses (*a*) and (*b*).

"Government auditor" means the Comptroller and Auditor-General of India, or any other person appointed by the Comptroller and Auditor-General of India in this regard.

Review by external experts

Every Financial Agency must arrange for a review of its performance and operations by a team of experts external to that Financial Agency. The review must take place once every three financial years. Every Financial Agency must make bye-laws in relation to the following matters regarding the team of external experts –

a) the required composition of the team;
b) the process of selection;
c) the process of appointment;
d) the terms of service; and
e) the duration and terms of the review.

The Financial Agency must ensure that –

(*a*) the team of external experts include experts in the same field as that of the Financial Agency; and

(*b*) there is no conflict of interest between the team of external experts and the Financial Agency.

The review under this provision must –

a) be based on international best principles, as relevant;

b) give an opinion on whether the Financial Agency is suitably designed and operating effectively; and
c) identify good practices and make proposals for the Financial Agency to consider.

The Financial Agency must ensure that the team of external experts has access to relevant information and resources as necessary to carry out the review. The board of the Financial Agency must, within 180 days of the review – determine a programme of action to implement the report of the review, as appropriate; publish the report of the review, including all opinions and proposals made by the team of external experts; and publish the programme of action.

Levy and collection of fees by a Financial Agency

The Central Government may make to a Financial Agency, grants or loans of such sums of money as it thinks fit for being utilised for the purposes of the Code.

A Financial Agency may levy and collect fees, as required for the discharge of its functions under the Code. In levying fees, the Financial Agency must take into consideration one or more of the following factors, as may be relevant –

a) the nature, scope and size of business carried out by the financial service provider;
b) the requirement that the levy of fees does not constrain competition;
c) the requirement that the levy of fees is not disproportionate to the costs likely to be incurred by the Financial Agency in discharging the functions for the fees will be levied; and
d) the financial requirements of the Financial Agency.

Confidentiality

Each Financial Agency, and every member of board of a Financial Agency, officer, and employee of a Financial Agency must maintain the confidentiality of any financial regulatory data and other commercially sensitive information that is obtained or produced in the discharge of any of its functions under the Code, unless –

a) any provision of this Code permits or requires its publication or disclosure;
b) any other law or any agreement in force permits or requires its publication or disclosure;
c) the person from whom it was obtained, and, if different, the person to whom it relates, consents;

d) it is already available to the public from other sources;
e) it is in the form of a summary or collection of information so framed that it is not possible to ascertain from it information relating to any particular person; or
f) it enables or assists the Financial Agency or the Central Government to discharge its functions under this Code.

The obligation extends to every member appointed to an advisory council to the board of a Financial Agency.

FINANCIAL CONSUMER PROTECTION - PART IV OF THE DRAFT CODE

Part IV (i.e. Chapters 17 to 31) deals with Financial Consumer Protection.

The global financial crisis has highlighted the need for more effective financial consumer protection measures as consumers face more sophisticated and complex financial markets. The availability of information has grown both in quantity and complexity and the pace of change, in terms of new product developments, product innovations, and technological advances, has increased dramatically. The complexity of financial markets and the existence of market failures in the form of information asymmetries, market externalities and differences in the bargaining powers of consumers and service providers, have created the need for a higher standard of protection for financial consumers. The need for financial consumers to be treated fairly makes it appropriate to adopt a more intrusive approach to financial regulation, when compared with most other fields.

Currently, the strategy in Indian finance is focused on the doctrine of caveat emptor - let the buyer beware. Beyond protection from fraud and provisions to ensure full disclosure, consumers are generally left to their own devices. The FSLR Commission felt that consumers of financial services are more vulnerable than consumers of ordinary goods and services, hence higher standards of protection ensured by special efforts of the State are justified. The vulnerability of consumers reflects a major gap in Indian financial regulation, which has to be addressed. As such, the Commission recommended the adoption of a consolidated, non-sector-specific, consumer protection framework for the entire financial system that will empower and require regulators to pursue consumer protection for the financial activities regulated by them. In this context, the draft Code has approached the problems of consumer protection on two fronts: prevention and cure.

The consumer protection part of the Code has three components: an enumerated set of rights and protections for consumers, an enumerated set of powers in the hands of the regulator, and principles that guide what power should be used under what circumstances. The details of consumer protection would, of course, lie in the subordinated legislation to be drafted by financial regulators.

In India, so far, the financial regulatory structure has been defined by sector, with multiple laws and often multiple agencies covering various sectors. This has led to inconsistent treatment, and regulatory arbitrage. Regulators have sometimes been lax in developing required protections out of notions of facilitating growth in the industry. These problems would be reduced by having a single principles-based law which would cover the entire financial system. The Commission felt that an overarching principle based body of law would allow regulatory flexibility, consistent treatment of consumers across all aspects of their engagement with the financial system, fairness and ultimately a more stable financial system.

The basic objective of consumer protection is to guard consumer interests and to promote public awareness. While pursuing these objectives, the regulator will be empowered to make regulations to determine the manner and extent to which the protections under the law will apply to the users of different financial products and services.

Objectives and Principles (Chapter 17)

The Regulator should discharge its functions and exercise its powers with the objective of – protecting and furthering the interests of consumers and promoting public awareness of matters relating to financial products and financial services.

The Regulator should have regard to the following principles while discharging its functions and exercising its powers –

a) the level of protection required by a consumer and the level of care required from a financial service provider, which may vary depending on –
    i. the level of knowledge, experience and expertise of the consumer;
    ii. the nature and degree of risk embodied in the financial product or financial service being availed by the consumer;

iii. the appropriateness of a financial product or financial service for different classes of consumers; and

iv. the extent of dependence of the consumer on the financial service provider;

b) consumers must ordinarily take responsibility for their transactional decisions;

c) any obligation imposed on a financial service provider should be reasonably commensurate with the benefits for consumers, considered in general terms, which are expected to result from the imposition of that obligation;

d) competition in the markets for financial products and financial services is desirable in the interests of consumers and therefore –

i. barriers to competition owing to adverse effects of regulatory actions should be minimised; and

ii. there should be competitive neutrality in the treatment of financial service providers;

e) facilitating access to financial products and financial services is desirable in the interests of consumers; and

f) innovation in financial products and financial services is desirable in the interests of consumers.

If the Regulator perceives a conflict between any of the principles contained above, or if more than one interpretation is possible, then the Regulator must reconcile and manage the conflict giving preference to the principle which would be the most relevant for furthering its objectives.

The Regulator must also take into account information received from the Redress Agency under Clause 123 while discharging its functions and exercising its powers. According to Clause 123, the Redress Agency must, through the Data Centre, share information on complaints received, considered, settled and determined by it, with the Regulator on an ongoing basis, in order to facilitate the Regulator in effectively carrying out its functions.

<u>Protection of Consumers (Chapter 18 of the Code)</u>

Requirement of professional diligence

A financial service provider must exercise professional diligence while entering into a financial contract or discharging any obligations under it.

"Professional diligence" means the standard of skill and care that a financial service provider would be reasonably expected to exercise towards a consumer, commensurate with –

(*a*) honest market practice;

(*b*) the principle of good faith;

(*c*) the level of knowledge, experience and expertise of the consumer;

(*d*) the nature and degree of risk embodied in the financial product or financial service being availed by the consumer; and

(*e*) the extent of dependence of the consumer on the financial service provider.

Unfair terms in financial contracts

An unfair term of a non-negotiated contract will be void.

A term is unfair if it –

a) causes a significant imbalance in the rights and obligations of the parties under the financial contract, to the detriment of the consumer; and
b) is not reasonably necessary to protect the legitimate interests of the financial service provider.

The factors to be taken into account while determining whether a term is unfair, include –

a) the nature of the financial product or financial service dealt with under the financial contract;
b) the extent of transparency of the term;
c) the extent to which the term allows a consumer to compare it with other financial contracts for similar financial products or financial services; and
d) the financial contract as a whole and the terms of any other contract on which it is dependent.

The Regulator can specify an illustrative list of terms that are considered to be unfair terms under this provision.

A term is transparent if it –

a) is expressed in reasonably plain language that is likely to be understood by the consumer;
b) is legible and presented clearly; and
c) is readily available to the consumer affected by the term.

If a term of a financial contract is determined to be unfair, the parties will continue to be bound by the remaining terms of the financial contract to the extent that the financial contract is capable of enforcement without the unfair term.

Non-negotiated contracts

Even if some terms of a financial contract are negotiated in form, the financial contract may be regarded as a non-negotiated contract if so indicated by –

a) an overall and substantial assessment of the financial contract; and
b) the substantial circumstances surrounding the financial contract.

In a claim that a financial contract is a non-negotiated contract, the onus of demonstrating otherwise will be on the financial service provider.

"Non-negotiated contract" means a contract whose terms, other than the terms contained in Clause 88, are not negotiated between the parties to the financial contract and includes –

a) a financial contract in which, relative to the consumer, the financial service provider has a substantially greater bargaining power in determining the terms of the financial contract; and
b) a standard form contract.

"Standard form contract" means a financial contract that is substantially not negotiable for the consumer, except for the terms contained in Clause 88.

Clause 88 of the Code deals with the terms that are unaffected. Unfair terms in a financial contract will not apply if it –

a) defines the subject matter of the financial contract;
b) sets the price that is paid, or payable, for the provision of the financial product or financial service under the financial contract and has been clearly disclosed to the consumer; or
c) is required, or expressly permitted, under any law or regulations.

The exemption under clause (b) above will not apply to a term that deals with the payment of an amount which is contingent on the occurrence or non-occurrence of any particular event.

Unfair and misleading conduct

Unfair conduct in relation to financial products or financial services is prohibited.

“Unfair conduct” means an act or omission by a financial service provider or its financial representative that significantly impairs, or is likely to significantly impair, the ability of a consumer to make an informed transactional decision and includes –

a) misleading conduct
b) abusive conduct and
c) such other conduct as may be specified.

Conduct of a financial service provider or its financial representative in relation to a determinative factor is misleading if it is likely to cause the consumer to take a transactional decision that the consumer would not have taken otherwise, and the conduct involves –

a) providing the consumer with inaccurate information or information that the financial service provider or financial representative does not believe to be true; or
b) providing accurate information to the consumer in a manner that is deceptive.

The following factors should be considered to be “determinative factors” for determining whether a conduct is misleading –

a) the main characteristics of a financial product or financial service, including its features, benefits and risks to the consumer;
b) the consumer’s need for a particular financial product or financial service or its suitability for the consumer;
c) the consideration to be paid for the financial product or financial service or the manner in which the consideration is calculated;
d) the existence, exclusion or effect of any term in a financial contract, which is material term in the context of that financial contract;
e) the nature, attributes and rights of the financial service provider, including its identity, regulatory status and affiliations; and
f) the rights of the consumer under any law or regulations.

Abusive conduct

A conduct of a financial service provider or its financial representative in relation to a financial product or financial service is abusive if it –

a) involves the use of coercion or undue influence; and
b) causes or is likely to cause the consumer to take a transactional decision that the consumer would not have taken otherwise.

While determining whether a conduct uses coercion or undue influence, the following must be considered –

a) the timing, location, nature or persistence of the conduct;
b) the use of threatening or abusive language or behaviour;
c) the exploitation of any particular misfortune or circumstance of the consumer, of which the financial service provider is aware, to influence the consumer's decision with regard to a financial product or financial service;
d) any non-contractual barriers imposed by the financial service provider where the consumer wishes to exercise rights under a financial contract, including –
    i. the right to terminate the financial contract;
    ii. the right to switch to another financial product or another financial service provider; and
e) a threat to take any action, depending on the circumstances in which the threat is made.

<u>Protection of Personal Information (Chapter 19)</u>

"Personal information" means any information that relates to a consumer or allows a consumer's identity to be inferred, directly or indirectly, and includes –

i. name and contact information;
ii. biometric information, in case of individuals;
iii. information relating to transactions in, or holdings of, financial products;
iv. information relating to the use of financial services; or
v. such other information as may be specified.

A financial service provider must –

a) not collect personal information relating to a consumer in excess of what is required for the provision of a financial product or financial service;
b) maintain the confidentiality of personal information relating to consumers and not disclose it to a third party, except in a manner expressly permitted below.
c) make best efforts to ensure that any personal information relating to a consumer that it holds is accurate, up to date and complete;
d) ensure that consumers can obtain reasonable access to their personal information, subject to any exceptions that the Regulator may specify; and

e) allow consumers an effective opportunity to seek modifications to their personal information to ensure that the personal information held by the financial service provider is accurate, up to date and complete.

A financial service provider may disclose personal information relating to a consumer to a third party only if –

a) it has obtained prior written informed consent of the consumer for the disclosure, after giving the consumer an effective opportunity to refuse consent;
b) the consumer has directed the disclosure to be made;
c) the Regulator has approved or ordered the disclosure, and unless prohibited by the relevant law or regulations, the consumer is given an opportunity to represent under such law or regulations against such disclosure;
d) the disclosure is required under any law or regulations, and unless prohibited by such law or regulations, the consumer is given an opportunity to represent under such law or regulations against such disclosure;
e) the disclosure is directly related to the provision of a financial product or financial service to the consumer, if the financial service provider –
    i. informs the consumer in advance that the personal information may be shared with a third party; and
    ii. makes arrangements to ensure that the third party maintains the confidentiality of the personal information in the same manner as required under this Part; or
f) the disclosure is made to protect against or prevent actual or potential fraud, unauthorised transactions or claims, if the financial service provider arranges with the third party to maintain the confidentiality of the personal information in the manner required under this Part.

"Third party" means any person other than the concerned financial service provider, including a person belonging to the same group as the financial service provider.

The Regulator may make regulations to –

a) provide additional requirements for the collection, storage, modification and protection of personal information by financial service providers, including – (*i*) the manner of maintenance of records of personal information and the time-periods for which the records are to be maintained; and (*ii*) the manner in which records of personal information should be dealt with after the expiry of the specified period;

b) exempt a class of financial service providers from the application of all or any portion of this Chapter or modify the manner in, or extent to which, all or any portion of the Chapter applies to them, subject to any specified conditions; or
c) establish mechanisms to ensure that consumers have access to, and are given an effective opportunity to seek modifications to, their personal information.

Requirement of fair disclosure (Chapter 20)

A financial service provider must ensure fair disclosure of information that is likely to be required by a consumer to make an informed transactional decision. In order to constitute fair disclosure, the information must be provided –

a) sufficiently before the consumer enters into a financial contract, so as to allow the consumer reasonable time to understand the information;
b) in writing and in a manner that is likely to be understood by a consumer belonging to a particular category; and
c) in a manner that enables the consumer to make reasonable comparison of the financial product or financial service with other similar financial products or financial services.

The Regulator can specify the types of information that must be disclosed to a consumer in relation to a financial product or financial service, which may include information regarding –

a) main characteristics of the financial product or financial service, including its features, benefits and risks to the consumer;
b) consideration to be paid for the financial product or financial service or the manner in which the consideration is calculated;
c) existence, exclusion or effect of any term in the financial product or financial contract;
d) nature, attributes and rights of the financial service provider, including its identity, regulatory status and affiliations;
e) contact details of the financial service provider and the methods of communication to be used between the financial service provider and the consumer;
f) rights of the consumer to rescind a financial contract within a specified period; or rights of the consumer under any law or regulations.

A financial service provider should provide a consumer that is availing a financial product or financial service provided by it, with the following continuing disclosures –

a) any material change to the information that was required to be disclosed at the time when the consumer initially availed the financial product or financial service;
b) information relating to the status or performance of a financial product held by the consumer, as may be required to assess the rights or interests in the financial product or financial service; and
c) any other information that may be specified.

A continuing disclosure must be made –

a) within a reasonable time-period from the occurrence of any material change or at reasonable periodic intervals, as applicable; and
b) in writing and in a manner that is likely to be understood by a consumer belonging to that category.

The Regulator may specify –

a) the nature of information that must be disclosed on a continuing basis to a consumer that has availed of a specified financial product or financial service;
b) the time-period within which continuing disclosures of information are to be made for a specified financial product or financial service; or
c) circumstances in which the consumer will have a right to terminate the financial contract upon a continuing disclosure being made.

The Regulator may make regulations to –

a) provide for the manner in which a disclosure of information relating to a financial product or financial service has to be made to a consumer; or
b) exempt a class of financial service providers from the application of all or any portion of this Chapter or modify the manner in, or extent to which, all or any portion of the Chapter applies to them, subject to any specified conditions.

<u>Redress of Complaints (Chapter 21 of the Code)</u>

A financial service provider must have in place an effective mechanism to receive and redress complaints from its consumers in relation to financial products or financial services provided by it, or on its behalf, in a prompt and fair manner.

A financial service provider must inform a consumer, at the commencement of relationship with the consumer and at such other time when the information is likely to be required by the consumer, of –

a) the consumer's right to seek redress for any complaints, including through the Redress Agency; and
b) the processes followed by the financial service provider to receive and redress complaints from its consumers.

The Regulator should make regulations on the processes to be followed by a financial service provider to receive and redress complaints from its consumers in an effective manner. The regulations should provide for –

a) the process to be followed by a consumer to file a complaint with a financial service provider and the time-period within which the complaint must be filed; and
b) the process to be followed by a financial service provider to receive and redress complaints and the time limits for each step of the process.

The regulations may, in addition, provide for –

a) the time-periods and intervals at which information under has to be provided;
b) the form and manner in which information has to be provided, including a requirement to make the information available on a financial service provider's website;
c) a requirement to maintain records of each complaint received by a financial service provider and the measures taken for its redress;
d) a requirement to submit periodic reports to the Regulator about the receipt and redress of complaints in the specified manner;
e) an alternate dispute resolution mechanism for complaints in relation to specified financial products or financial services to be followed after, or in place of, the financial service provider's redress process;
f) the process to be followed where two or more financial service providers may be jointly responsible for the redress of a complaint; or
g) any other matter relevant to the redress of complaints.

Suitability of advice for retail consumers (Chapter 22 of the Code)

Any person who advises a retail consumer in relation to the purchase of a financial product or service must obtain relevant information about the needs and circumstances of the consumer before making a recommendation to the consumer. The retail advisor should ensure that the advice given is suitable for the retail consumer after due consideration of the relevant personal circumstances of the retail consumer.

This is due to the fact that retail consumers may often be in a situation where they are not able to fully appreciate the features or implications of a financial product, even with full disclosure of information to them, thus enforcing the need for a thorough suitability assessment of the products being sold to them.

The Regulator may make regulations regarding suitability of advice. The regulator may specify the type of enquiries that need to be made to determine the relevant personal circumstances of retail consumers for a financial product or financial service; or that certain types of communications issued by a financial service provider to a retail consumer would not constitute advice.

In case of conflict, the interests of consumers should take precedence. This is to ensure good consumer protection so as to align the incentives of financial service providers with those of consumers.

A retail advisor should provide a retail consumer with information regarding any conflict of interests, including any conflicted remuneration that the retail advisor has received or expects to receive for making the advice to the retail consumer and give priority to the interests of the retail consumer if the advisor knows, or reasonably ought to know, of a conflict between its own interests and the interests of the retail consumer; or the interests of the concerned financial service provider and interests of the retail consumer, in cases where the advisor is a financial representative. The information should be given to the retail consumer in writing and in a manner that is likely to be understood by the retail consumer and a written acknowledgement of the receipt of the information should be obtained from the retail consumer.

Powers and functions of the Regulator (Chapter 23 of the Code)

For ensuring financial consumer protection, regulators should be able to set minimum standards for financial products to ensure fair contract terms and charges, and comprehensibility.

The general functions of a regulator will include –

- making regulations to carry out the purposes of the law;
- issuing guidance to financial service providers;
- supervising the conduct of financial service providers to ensure compliance with the law;
- taking appropriate enforcement actions to deal with any violations;
- Carry out financial awareness programmes.

In addition to the general functions of rule-making, supervision and enforcement, the draft Code also contains the following specific provisions –

i. Registration of individuals dealing with consumers

   A financial service provider must ensure that no individual deals with consumers in connection with the provision of a financial product or financial service by it or on its behalf, including as an employee or financial representative, unless that individual is registered with the Regulator.

   Any act or omission by a financial representative of a financial service provider, in connection with the provision of a financial product or financial service on behalf of the financial service provider, will also be deemed to be an act or omission by the financial service provider.

ii. Information on new products

   A financial service provider should file specified information with the Regulator in relation to – any financial product that it proposes to offer to consumers; or any material variation to a financial product already offered to consumers.

   A financial service provider should not offer a financial product to consumers unless it has filed the specified information with the Regulator in respect of the financial product; and a period of sixty days has elapsed from the date of filing of the specified information with the Regulator. If the Regulator does not seek any additional information or clarifications, the financial service provider can commence offering the product to consumers after the expiry of the period of sixty days.

iii. Power to specify modifications

The regulator should be able to intervene in situations where certain features or aspects of a financial product or service are found to be harmful for consumers after it has been introduced in the market. The draft Code therefore allows the regulator to specify modifications in the terms and conditions of particular financial contracts or the process of delivering particular financial services. Such regulatory interventions must therefore be accompanied by a statement explaining the other interventions that were considered by the regulator to address the problem and the reasons why such interventions were found to be inadequate. This statement is in addition to the regular requirements of the regulation-making process.

Redress Agency (Chapter 24 to 27 of the Code)

The draft Code envisages the creation of a new statutory body to redress complaints of retail consumers through a process of mediation and adjudication. The redress agency will function as a unified grievance redress system for all financial services. To ensure complete fairness and avoid any conflicts of interest, the redress agency will function independently from the regulators. This proposed redress mechanism will replace the existing financial sector-specific ombudsman systems such as the banking ombudsman and the insurance ombudsman although retail consumers will continue to have the option to approach other available forums, such as the consumer courts and regular courts.

The Redress Agency will redress the complaints of retail consumers, received directly or forwarded by the Regulator, in cases where –

a) the complainant has already made a complaint to the respondent and –
    i. the respondent has failed to resolve the complaint within the time period specified by the Regulators; or
    ii. the complainant is not satisfied with the resolution of the complaint by the respondent;
b) proceedings concerning the subject-matter of the complaint are not pending before any other competent court, tribunal or other authority set up by or under any other law for the time being in force; and

c) a final order on the subject-matter of the complaint has not been made by any other court, tribunal or other authority.

The Redress Agency must discharge its function in a fair, informal, economical and expeditious manner, through – mediation between the complainant and respondent to arrive at a voluntary settlement of the complaint and if a complaint is not redressed through mediation, adjudication of the complaint.

A complaint that is received directly by the Redress Agency or forwarded by the Regulator must be screened before it is referred for mediation. The mediator must assist the complainant and respondent to arrive at a voluntary settlement of the complaint. If the complainant and the respondent arrive at a settlement through mediation, the mediator must record the settlement in writing in the form of a settlement agreement to be signed by the complainant, respondent and the mediator. The settlement agreement, unless it is determined to be invalid by the adjudicator, will be binding on the complainant and respondent and will be enforceable as though it were a decree of a civil court. An adjudication order is also enforceable in the same manner as though it were a decree of a civil court.

The redress agency should put in place adequate systems, processes, technology and infrastructure to enable it to efficiently discharge its functions. The regulators are empowered to impose service level requirements on the redress agency with measurable targets on matters such as the total cost to parties for proceedings before it, compliance cost for financial firms and time-periods for each step of the redress process. The redress agency has the discretion to open offices anywhere in the country.

A party that is dissatisfied with the adjudicator's orders will have the right to bring an appeal before the FSAT (Financial Sector Appellate Tribunal) and appeals from FSAT will lie before the Supreme Court.

The Redress Agency must, through the Data Centre, share information on complaints received, considered, settled and determined by it, with the Regulator on an ongoing basis, in order to facilitate the Regulator in effectively carrying out its functions.

Financial awareness (Chapter 28 of the Code)

Financial awareness means the understanding and knowledge of members of the public regarding financial matters, including, the benefits of financial planning; rights and protections available to consumers of financial products and financial services; and features, costs, risks and benefits of different financial products and financial services.

The Regulator should undertake measures to promote financial awareness. The Regulator can establish a separate body corporate to carry out the promotion of financial awareness. The regulator should ensure that appropriate mechanisms are in place to achieve and monitor the achievement of the financial awareness objective. The regulator can also make regulations to effectively discharge it function of financial awareness.

Advisory council on consumer Protection (Chapter 29 of the Code)

The Code provides for creation of an advisory council on consumer protection to monitor and contribute towards the regulator's consumer protection objectives. The advisory council will be responsible for –

a) making representations, in the form of advice, comments or recommendations, on the regulator's policies and practices;

b) reviewing, monitoring, and reporting to the regulator on the effectiveness of its policies and practices;

c) creating reports stating its views on all draft regulations published by the regulator.

The Consumer Advisory Council will consist of a minimum of five and a maximum of nine members who are consumers or persons representing the interests of consumers, to be appointed by the Regulator. The Regulator must ensure that the membership of the Consumer Advisory Council gives a fair degree of representation to experts in the fields of personal finance and consumer rights. While appointing the members of the Consumer Advisory Council the Regulator must also take into account the need to ensure proper geographical representation from across the country. The Regulator must appoint one of the members of the Consumer Advisory Council to be the chairperson of the Consumer Advisory Council of the Consumer Advisory Council.

The Regulator must take into account any representations or reports that are made to it by the Consumer Advisory Council in discharge of its functions. If the Regulator disagrees with a view expressed, or proposal made, in the representation or report, it must give the Consumer Advisory Council a statement in writing of its reasons for disagreeing.

Interaction between the Competition Commission and the Regulator (Chapter 30 of the Code)

Presently the Competition Commission of India (CCI) is the authority responsible for competition policy issues in India. It is charged with the duty of fostering greater competition in all areas of the economy. A structured mechanism for interaction and co-operation between the CCI and financial regulators is provided under the Code.

The CCI should review draft regulations issued by the regulator for public comments and provide its inputs on the potential competition implications, if any. The regulator must consider the representation made by CCI before finalizing the regulations.

The CCI should be empowered to monitor the effects on competition of any regulatory actions and practices on an ongoing basis. If the regulator and the CCI disagree on the course of action to be taken, the CCI will have the power to direct the regulator to take specified actions to address the negative effects on competition identified by the CCI.

The Code also requires the CCI and the regulator to enter into a memorandum of understanding to establish the procedures for co-operation between them, which may be modified by them from time to time.

Effect of other laws (Chapter 31 of the Code)

The Central Government may, by notification, provide that nothing contained in the Consumer Protection Act, 1986 will apply to a retail consumer in respect of any complaint covered under the Code, in such parts of India, as considered necessary, from such date as may be notified by the Central Government.

A notification may be issued by the Central Government if it is satisfied that –

a) the number of complaints being referred to the Redress Agency under the Code are significantly higher than the complaints referred to the consumer courts established under the Consumer Protection Act, 1986;
b) the Redress Agency is effectively discharging its functions under the Code;
c) the issuance of the notification will not cause a significant detriment to the interests of retail consumers.

PRUDENTIAL REGULATION – PART V OF THE DRAFT CODE

Chapters 32 to 37 deal with prudential regulation under the Draft Code.

Micro-prudential regulation refers to the regulation that governs safety and soundness of certain financial service providers. The rationale, scope and extent of micro-prudential regulation are primarily motivated by consumer protection concerns. Additionally, the possibility of large numbers of financial service providers failing at the same time, or a systemically important financial institution failing, can raise concerns about the stability and resilience of the financial system as a whole. Sound micro-prudential regulation then, plays a role in mitigating systemic risk as well.

The Regulator must take into account the following principles while discharging its functions and exercising its powers under prudential regulation –

a) any obligation imposed on regulated persons should be proportionate to
    i. the nature, scale and complexity of the risks inherent in the regulated activity being carried on by the regulated person;
    ii. the manner in which the regulated activity ranks on the factors contained in clause 151(1)(*b*); and
    iii. in case of regulated persons that are Systemically Important Financial Institutions, the relevance of the regulated person for the stability and resilience of the financial system;
b) the feasibility of supervision by the Regulator and implementation of regulatory actions by regulated persons;
c) persons who control, oversee and manage the affairs of regulated persons must share the responsibility of ensuring the safety and soundness of the regulated persons;

d) minimisation of inconsistencies in the regulatory approach towards regulated activities that are similar in nature or pose similar risks to the fulfilment of the Regulator's objectives under this Part;
e) any obligation imposed on regulated persons should be consistent with the benefits, considered in general terms, which are expected to result from the imposition of that obligation;
f) competition in the markets for financial products and financial services is desirable in the interests of consumers and therefore –
   i. barriers to competition owing to adverse effects of regulatory actions should be minimised; and
   ii. there should be competitive neutrality in the treatment of financial service providers;
g) facilitating access to financial products and financial services is desirable in the interests of consumers;
h) innovation in financial products and financial services is desirable in the interests of consumers;
i) regulatory actions should be carried out in a manner that is least detrimental to the global competitiveness of the financial system;
j) the effects of regulatory actions over a continuing period of time, which means a period of at least five years after a regulatory action is taken, should be considered; and
k) the effects of regulatory actions on the stability and resilience of the financial system, in particular, the need to minimise pro-cyclical effects, should be considered.

Authorisation to carry on the business of providing financial services (Chapter 33 of the Code)

Authorisation to carry on the business of financial services

Every person who wants to carry on the business of providing a financial service in India, whether on its own behalf or on behalf of any other person, should obtain an authorisation from the Regulator to carry on the business of providing that financial service.

Authorisation will not be required for –

a) an individual registered with the Regulator under clause 104;

b) a financial representative of a financial service provider, if –
    i. the financial representative is carrying on an activity that is connected with the provision of a financial service for which the concerned financial service provider is authorised;
    ii. the concerned financial service provider has accepted responsibility in writing for the activities of the financial representative; and
    iii. the financial representative complies with such other requirements as may be specified.

c) the Central Government or a State Government while carrying out specified financial services, if so provided under regulations made by the Regulator in this regard.

Grant of authorisation

A request for authorisation to carry on a financial service must be made to the Regulator in the form of an application. The Regulator may issue an approval order granting authorisation for the carrying on of any or all the financial services in respect of which an application is made after being satisfied that the person making the application –

(*a*) satisfies the authorisation criteria specified by the Regulator if any such authorisation criteria is specified; or

(*b*) shows sufficient evidence of being in a position to comply with the provisions of the Code.

The specified authorisation criteria in relation to a financial service may include requirements in relation to one or more of the following matters –

a. the capital structure of the applicant, including the minimum capital required to be held by it;
b. the legal and organisational structure of the applicant;
c. the ownership structure of the applicant, including restrictions on ownership of the applicant by specified persons or class of persons;
d. the systems of governance required to be put in place by the applicant;
e. fit and proper person criteria for persons engaged in the oversight or strategic management of the applicant;

f. conditions to be satisfied in case the applicant is a member of a specified type of group;
g. evidence of being in a position to comply with the relevant prudential requirements, if, and to the extent, applicable; and
h. any other criteria that the Regulator may specify.

Authorisation through self-registration

The Regulator must specify the categories of financial service providers that will be entitled to obtain authorisation through self-registration, subject to such conditions as may be specified. The self-registration process will not apply to any person that proposes to carry out a financial service –

a) that is specified to be a regulated activity; or
b) in respect of which any authorisation criteria has been specified.

Prudential Requirements

The regulator has the powers to prescribe ways in which the regulated persons can avoid or reduce the risks they take. Regulator may impose restrictions on how the regulated persons invests the funds - their own funds and those of the consumers. In some cases, they may also impose restrictions on claims that may be placed from the regulated person's over business on consumers' funds. Regulator may also require adherence to certain business processes that reduce risks to the regulated persons. The draft Code also empowers the regulator to impose liquidity requirements on the regulated persons.

The regulator will have the following powers in connection with reducing risks:

1) Regulating investments of own funds and consumers' funds;
2) Regulating claims on consumers' funds;
3) Regulating to foster business processes that reduce risks;
4) Regulating the valuation standards for assets and liabilities of regulated persons;
5) Regulating transactions with related persons; and
6) Regulating liquidity management.

The regulator will have the following powers in connection with absorbing losses:

1) Defining categories of capital resources, based loss absorbing capacities;
2) Prescribing the amount of different types of capital resources required to be held, and the solvency requirements;
3) Defining criteria for assessing compliance with capital resource requirements;
4) Defining how regulated persons should manage the capital resources, including the requirement to notify the regulator while issuing certain capital instruments;
5) Regulating how the changes in values of assets and liabilities will be recognised; and
6) Mandating purchase of insurance from Resolution Corporation.

The regulator will have the following powers in connection with improving governance and management:

1) Regulating norms of corporate governance;
2) Regulating the structure of management incentives;
3) Regulating risk management systems;
4) Regulating internal controls and internal audit;
5) Regulating appointment of qualified auditors and actuaries; and
6) Regulating outsourcing and appointment of agents.

The regulator will have the following powers in connection with monitoring and supervision:

1) Mandating disclosures to consumers and the market;
2) Mandating reporting to the regulator;
3) Conducting on-site supervision;
4) Investigating powers; and
5) Developing the capability to conduct analytics on the information received from regulated persons and other resources.

For regulated persons that are under the regulatory purview of more than one regulator, there should be a requirement for the regulators to co-operate to ensure optimal supervision. This may entail conglomerate supervision or supervision of a single regulated person undertaking multiple activities. No specific mode of co-operation has been prescribed and the regulators will be expected to develop co-operation through mutual understanding and agreement.

Auditors and Actuaries

A regulated person must appoint an auditor, actuary or any other person performing a similar function, as may be specified by the Regulator.

An auditor or actuary appointed under the Code to act for a regulated person – will have the right to access the books and records of the regulated person at all times; and will be entitled to require such information and explanations from the regulated person or its officers, as it reasonably considers necessary for the performance of its duties as an auditor or actuary.

If it appears to the Regulator that an auditor or actuary appointed under the Code to act for a regulated person has failed to comply with the requirements imposed on it it may disqualify the person from acting as the auditor or actuary, as the case may be, for any regulated person or any particular category of regulated persons.

If the Regulator proposes to disqualify an auditor or actuary it must give the person a show-cause notice after which if it makes a decision to disqualify the person it must issue a decision order. The Regulator may cancel a decision notice imposing a disqualification imposed if satisfied that the disqualified person will in future comply with the duty in question. A person who has been issued a decision order under this section may appeal to the Tribunal.

Actions involving regulated persons

No person should carry out any of the following actions without complying with the provisions of the Code –

a) a merger, amalgamation or restructuring involving a regulated person;
b) the transfer or acquisition of control of, or significant interest in, a regulated person;
c) sale, disposal or acquisition of the whole, or substantially the whole, of the undertaking of a regulated person or a significant portion of its assets or liabilities; or
d) voluntary winding up, dissolution or similar action involving a regulated person or discontinuation of its business in any other manner.

A person that proposes to take an action must make an application to the Regulator.

Transactions with related persons

A regulated person must ensure that transactions with related persons are entered into on an arms-length basis and the terms of such transactions are no more favourable than the terms contained in, or likely to be contained in, corresponding transactions with persons other than related persons. While making regulations, the Regulator must take into account –

a) the risks arising from the related person transaction to the safety and soundness of the regulated person;
b) the conflict of interest that may arise on account of the related person transaction; and
c) the manner in which the related party transaction may affect the ability of the regulated person to effectively discharge its obligations towards its consumers.

Functions and Powers of the Regulator

The regulator must consider the following principles in discharging its functions and exercising its powers:

1) Any obligation imposed on regulated persons should be proportionate to the nature, scale and complexity of the risks in the regulated activity being carried out; and the manner in which the regulated activity ranks;
2) Regulatory approach needs to take into account the feasibility of implementation by regulated persons and supervision by the Regulator;
3) The need to minimise inconsistencies in the regulatory approach towards regulated activities that are similar in nature or pose similar risks to the fulfilment of the Regulator's objectives under the Code;
4) Any obligation imposed on regulated persons should be consistent with the benefits, considered in general terms, which are expected to result from the imposition of that obligation;
5) The desirability of facilitating competition in the markets for financial products and financial services and minimising the adverse effects of regulatory actions on competition in the financial sector;
6) The desirability of facilitating access to financial products and financial services;
7) The desirability of facilitating innovation in financial products and financial services;
8) The need to ensure that regulatory actions are carried out in a manner that is least detrimental to competitiveness of India's financial system;
9) The need to take into account the long-term implications of regulatory actions, which will include a period of at least five years following a regulatory action;
10) The need to minimise the pro-cyclical effects of regulatory actions; and

11) The requirement that persons who control and manage the affairs of regulated persons must share the responsibility of ensuring the safety and soundness of the regulated persons.

CONTRACTS, TRADING AND MARKET ABUSE - PART VI OF THE DRFAT CODE

Part VI of the Code deals with contracts, trading and market abuse.

Principles relating to certain contracts like insurance and securities are covered under Chapter 38 of the Code. Provisions covering Infrastructure Institutions are covered under Chapter 39 & 40 of the Code. Byelaws, requirement for governance and monitoring mechanisms, liability, contractual issues etc are covered under this chapter.

Issue and listing of securities

Issue and listing of securities are covered under Chapter 41 of the Code.

A public offering of securities must be pursuant to filing of a statement providing adequate information about the issuer and the security being issued, with the Regulator. Every issuer making a public offering has an obligation to –

a) provide adequate information, before a public offering is made, about the issuer and the security to allow persons to make adequately informed decision to subscribe to such public offering;
b) provide adequate information, on a regular basis, about the issuer and the securities to allow persons to make adequately informed decisions about dealing in such securities; and
c) have in place systems of governance and processes to ensure that the functions of the issuer do not discriminate between owners of a class of securities of the issuer.

If the public offering is made by a person other than the issuer, then the person must provide information which is relevant for a potential subscriber of the issue to make an informed decision.

Any security with respect to which a public offering has been made must be listed on an exchange. If any class of securities is listed on an exchange, further issue of the same class of securities of the same issuer must be listed.

Securities listed may be de-listed if any of the following conditions are met –

(*a*) the issuer of the security makes an application for de-listing; or

(*b*) the security does not have enough liquidity and may be used for market abuse.

Owners of securities listed on an exchange must be provided with the opportunity to sell their securities at a fair price in the event of an actual or potential change in the control of the issuer.

The issuer must ensure that any buy back of securities by the issuer is carried out in a manner which-

(*a*) does not discriminate between owners of the securities;

(*b*) provides a fair value to persons from whom the securities are bought back; and

(*c*) is equitable to those who choose to sell their securities.

Market Abuse

Market Abuse is covered under Chapter 42 of the Draft Code.

A person commits market abuse if the conduct of such person is intended to interfere with free and fair operation of the securities market by, hampering the ability of persons to make informed decisions in relation to dealing in securities, and is carried out to make a financial gain and includes criminal market abuse.

A person commits insider trading if that person, while in possession of unpublished price sensitive information, in breach of a fiduciary duty or other relationship of trust or confidence, for the purpose of making a financial gain –

(*a*) deals, directly or indirectly, in securities; or

(*b*) discloses, actively or otherwise, unpublished price sensitive information to any other person likely to engage in insider trading.

The Regulator may make regulations specifying conduct which amounts to market abuse. The Regulator may make different regulations for different securities or different classes of persons. The Regulator may exempt specified securities or specified classes of persons.

RESOLUTION OF FINANCIAL SERVICE PROVIDERS – PART VII OF THE DRAFT CODE

Chapter 43 to 54 covers resolution of financial service providers.

Establishing a sophisticated resolution corporation is essential to strong responses to the possible failure of a large financial firm and its consequences for the Indian economy. A unified resolution corporation that will deal with an array of financial firms such as banks and insurance companies; it will not just be a bank deposit insurance corporation. The corporation will concern itself with all financial firms that make highly intense promises to consumers, such as banks, insurance companies, defined benefit pension funds, and payment systems. The corporation will also take responsibility for the graceful resolution of systemically important financial firms, even if they have no direct link to consumers.

The defining feature of the resolution corporation will be its speed of action. It must stop a financial firm while the firm is not yet insolvent. The resolution corporation will choose between many tools through which the interests of consumers are protected, such as sales, assisted sales, mergers and other arrangements.

The resolution corporation must have representation from across the financial regulatory architecture, including the central bank, financial regulators, and the Central Government, and must be headed by a chief executive. The resolution corporation must have representation of independent experts. The resolution corporation must also have an administrative law member on its board. The establishment of the resolution corporation will be carried out in alignment with the principles of legal process identified by the Commission.

Resolution of covered service providers that are approaching failure should be carried out with the objectives of:

1. Protecting the stability and resilience of the financial system;
2. Enhancing financial market efficiency through efficient pricing and allocation of risk;
3. Protecting consumers of covered obligations up to a reasonable limit; and
4. Protecting public funds.

The resolution corporation regime must enhance financial market efficiency. It must not restrict market participants from innovation or taking calculated risks. Instead, it should facilitate the efficient pricing and allocation of risk, and the internalisation of the costs of firm failure.

An important aspect of the resolution framework centres around the protection of consumers in proportion to the nature, scale and complexity of obligations owed by the regulated entity; and to prioritise claims according to the hierarchy determined by such obligations.

The draft Code on resolution obliges the resolution corporation, the micro-prudential regulators, the competition regulator and the FSDC to consult and co-ordinate regularly and frequently, achieves regulatory harmonisation, and share information.

The resolution corporation and the micro-prudential regulators must together establish a framework for prompt corrective action to identify risks to covered service providers at an early stage, and to ensure their timely resolution.

Therefore, the law must provide for the determination of:

1. Indicators or measures of risk assessment by the micro-prudential regulator; and
2. Stages identifying the risk to the viability of covered service providers based on these indicators or measures.

A resolution action by the resolution corporation may include the following:

1. Transfer of shares, property, rights and obligations in contracts;
2. Change in the management of the firm, even resulting in removal of certain workforce;
3. Compensation; and
4. Liquidation of the covered service provider.

Since the resolution corporation closely monitors the viability of a covered service provider and works towards bringing the institution to a less riskier financial state, it is best suited to determine when a covered service provider should be liquidated. As such, if the resolution corporation determines that a covered service provider has failed, the covered service provider would proceed to liquidation.

<u>FINANCIAL STABILITY AND DEVELOPMENT COUNCIL – PART VIII OF THE DRAFT CODE</u>

Provisions relating to FSDC are covered under Chapters 55 to 58.

The Council will pursue the objective of fostering the stability and resilience of the financial system, by-

a) identifying and monitoring systemic risk; and
b) taking all required action to eliminate or mitigate systemic risk.

The office of the Council will consist of the Council Board, an Executive Committee, a Secretariat, and a Data Centre. Executive Committee will have administrative and managerial control over the affairs of the Council. The Secretariat will be headed by the Council Chief Executive.

The Council must –

a) conduct data analysis and research;
b) designate financial service providers as Systemically Important Financial Institutions;
c) formulate and implement the application of system-wide measures to the financial system;
d) promote co-operation and co-ordination among members and Financial Agencies;
e) assist the members and Financial Agencies in the performance of their functions;
f) assist the Central Government, members and Financial Agencies during a financial system crisis; and
g) ensure the performance of all other actions that are required to be undertaken by the Council under the Code.

The Council must facilitate co-ordination and co-operation among Financial Agencies. 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.

The Council must specify, as frequently as appropriate, the parameters for the identification and determination of a financial system crisis.

<u>DEVELOPMENT – PART IX OF THE DRAFT CODE</u>

The Regulator must pursue the objective of fostering the development or improvement of market infrastructure or market process under this Part.

The Regulator may, through regulations, adopt any of the following measures to pursue its objectives-

a) measures to modernise market infrastructure or market process, including in particular, the adoption of new technology;
b) measures to provide for product differentiation, or enlarging consumer participation; or
c) measures to align market infrastructure or market process with international best practices.

There must be a review of every measure that has been adopted and every direction that has been issued.

RESERVE BANK OF INDIA – PART X OF THE DRAFT CODE

Chapters 61 to 65 covers the provisions related to RBI.

The objectives of the Reserve Bank are to –

(*a*) formulate and implement monetary policy; and

(*b*) carry on other activities of a central bank, including –

(*i*) to issue currency of India;

(*ii*) to transact certain business of the Central Government and the State Government, as contained in Clause 348 and 349 respectively; and

(*iii*) to act as banker to banking service providers.

The objectives of the Reserve Bank in the discharge of its monetary policy function must be provided by the Central Government, in consultation with the Reserve Bank Chairperson, by way of a written statement, which identifies and provides –

(*a*) an explanation of the predominant objective of the Reserve Bank in discharge of its monetary policy function; and

(*b*) an explanation of any additional objectives, if relevant, and the order of priority in which the additional objectives must be achieved.

Monetary Policy Committee, will be responsible for formulating the monetary policy of the Reserve Bank.

Other powers of the Central Bank are –

(*a*) receive money on deposit and pay interest on the deposits;

(*b*) purchase, sell, discount and rediscount bills of exchange, promissory notes and treasury bills;

(*c*) purchase and sell government securities;
(*d*) hold, purchase and sell securities issued by foreign countries;
(*e*) maintain deposits with other banks, including foreign banks;
(*f*) purchase and sell special drawing rights issued by the International Monetary Fund;
(*g*) purchase, sell and otherwise deal in gold, specie and other precious metals;
(*h*) establish credits and give guarantees;
(*i*) open accounts in a central bank in any other country or in the Bank for International Settlements or any other international or regional bank, and to act as agent or mandatory or depository or correspondent for any of those banks or organisations and pay interest on any of those deposits;
(*j*) issue bills and drafts and effect transfers of money; and
(*k*) acquire, hold, lease or dispose immovable property.

CAPITAL CONTROLS – PART XI OF THE DRAFT CODE

Chapters 66 to 72 deals with capital controls.

Capital controls are restrictions on the movement of capital across borders. Typically, capital controls include a range of measures from reserve requirements to quantitative limits, licensing requirements and outright bans. Controls may be imposed economy-wide or may apply only to specific sectors. In addition, restrictions may apply to all kinds of flows or may differentiate by type or duration of flows.

Under the draft Code, there is a liberalised regime where foreign exchange for the purposes of current account transactions can be freely brought into the country or taken out of the country. This will be subject only to tax and money laundering considerations, as currently applicable.

The design of the draft Code on capital controls focuses on accountability and legal process, and leaves the questions of sequencing and timing of capital account liberalisation to policy makers in the future.

The rules governing capital controls on inward flows and consequent outflows i.e. repayment of the principal amount, should be framed by the Central Government, in consultation with the RBI. The regulations governing capital controls on outward flows should be framed by the RBI, in consultation with the Central Government.

The draft Code addresses fundamental concerns in the framework of capital controls, and provides for the following:

1. The rules on capital account transactions for all inbound flows including outflows that arise as a consequence of these inflows, will be made by the Central Government in consultation with the RBI. The regulations on capital account transactions for all outbound flows will be made by the RBI in consultation with the Central Government.
2. A single investment vehicle for investment in India i.e., qualified foreign investors (those foreign investors who meet the customer due diligence criteria prescribed by the Central Government);
3. A sound legal process while making rules for capital account transactions and while granting approvals;
4. A framework for imposition of controls in emergency situations (such as war, natural calamity and balance of payment crises);
5. Review or restrictions on capital account transactions on national security considerations, by the Central Government or the RBI for inbound and outbound flows, respectively;
6. Review of decisions of the Central Government and the RBI; and
7. The principle that once controls are imposed at the entry level there must be equal treatment for Indian investors and foreign investors.

Ensuring compliance of provisions on capital controls in the draft Code, rules and regulations in relation to the capital controls is placed with the RBI in the draft Code. This would include oversight of reporting of foreign exchange transactions with the FDMC and ensuring compliance of the law, rules and regulations. Under conditions of full capital account convertibility, these functions will be placed with the Central Government.

PUBLIC DEBT MANAGEMENT AGENCY – PART XII OF THE DRAFT CODE

The governance and operations of the public debt management agency would be handled through a two-tiered arrangement. At the top, there would be an advisory council, comprising of experts in finance, law, and public debt management. The advisory council must advise and issue opinions on any matter related to the objectives and functions of the public debt management agency that is referred to it by the agency or the Central Government. It must also advise and provide its opinion on the financing plans submitted by the public debt management agency to the Central Government, as well as the agency's annual report, whenever such opinion is sought. The council must meet periodically to review and ratify the borrowing programme for the upcoming months.

The main benefit of an independent public debt management agency will come through the integration of public debt management functions and various databases and information, which are currently dispersed. By unifying the public debt management function, and efficiently linking it with the cash and the investment management functions, there will be improved information, analysis and thus decision making. With specialised human resources at its disposal, the public debt management agency can contribute to a more effective interface with the market resulting in Cost-efficient management of Government borrowings. A specialised, unified and independent agency will have significant comparative advantage over the existing structure of a fractured and uncoordinated Government borrowing programme spread across various agencies.

The key functions of the public debt management agency would be to undertake public debt and cash management for the Central Government. In addition to these, the various functions of the public debt management agency include the management of contingent liabilities, research and information, and the fostering of a liquid and efficient market for Government securities. These

INVESTIGATIONS, ENFORCEMENT ACTIONS AND OFFENCES – PART XIII OF THE DRAFT CODE

Chapters 77 to 82 cover the process of investigation, enforcement actions and offences.

Where a Financial Agency has information or reasonable grounds to suspect that any person is violating, or has violated, any provisions of the Act or relevant regulations, the Financial Agency may investigate such violation. The Financial Agency must issue a show cause notice to a person against whom it proposes to undertake an enforcement action. Any person who has received a decision order may make an application to the administrative law member of the board of the Financial Agency for review of the decision order, within fourteen days from the date of such order. The Financial Agency must make regulations governing the show cause notices and decision orders it issues.

Each of the following constitutes an "enforcement action" under this Act –
(*a*) issuance of a private warning;
(*b*) issuance of a public statement;
(*c*) issuance of a direction requiring the person to correct the violation;
(*d*) imposition of a monetary penalty; and
(*e*) variation, suspension, or cancellation of an authorisation, permission or registration granted by the Financial Agency to the person, which are related to the violation.

The total amount of the monetary penalty must not be more than rupees one crore, or any amount that the Central Government may prescribe from time to time, if the amount of loss caused, or likely to have been caused, is – not substantial; or cannot be reasonably estimated.

The punishment for –
(*a*) a Class A offence is a fine, or imprisonment not less than two years but up to ten years, or both;
(*b*) a Class B offence is a fine, or imprisonment up to two years, or both; and
(*c*) a Class C offence is a fine.
All offences under the Code are non-cognisable and compoundable. If any act is punishable under provisions of any other law, the provisions of the Code will not be in derogation to such provisions.

FUNCTIONS, POWERS AND DUTIES OF THE TRIBUNAL – PART XIV OF THE DRAFT CODE

A person will not be qualified for appointment as the Presiding Officer of the Tribunal unless such person –
(*a*) is a sitting or retired Judge of the Supreme Court or a sitting or retired Chief Justice of a High Court; or
(*b*) is a sitting or retired Judge of a High Court who has completed not less than seven years of service as a Judge in a High Court.

A person will not be qualified for appointment as member of the Tribunal unless that person is a person of ability, integrity and standing who has shown capacity in dealing with problems relating to finance and has qualification and 15 experience of law, finance, economics or accountancy. A person may not be appointed as member of the Tribunal within two years from retiring or resigning as a member of the board or employee of any Financial Agency.

The Central Government must constitute a selection committee in accordance with the First Schedule for selection of the persons for appointment as Presiding Officer or members of the Tribunal.

The Presiding Officer and members of the Tribunal will hold their respective offices till they reach the age of seventy years.

The Tribunal will have the same powers as are vested in a Civil Court under the Code of Civil Procedure, 1908 but will not be bound by the procedure laid down in the Code of Civil Procedure, 1908.

The Tribunal must attempt to dispose any appeal before it within a period of one hundred and eighty days from the date of receipt of any appeal. If the Tribunal does not dispose any appeal within one hundred and eighty days it must record such incidence and publish it with its annual report.

If the Tribunal is satisfied that the person has defaulted in payment of penalty, it may issue an order attaching properties of the person.

The Presiding Officer may constitute benches composed of members of the Tribunal. Benches may be created at any location, or for any type of proceeding.

An aggrieved party may appeal to the Supreme Court of India against the order of the Tribunal only on a question of law, within a period of ninety days from the receipt of the order of the Tribunal.

Any person may appear before the Tribunal in person, or authorise one or more –

(*a*) of its officers;

(*b*) advocate;

(*c*) chartered accountant;

(*d*) company secretary; or

(*e*) cost accountant.

6. LIST OF LEGISLATIONS TO BE REPEALED BY THE CODE

Following is a list of legislations to be repealed:

1. The Securities Contracts (Regulation) Act, 1956
2. The Securities and Exchange Board of India Act, 1992
3. The Depositories Act, 1996
4. The Public Debt Act, 1944
5. The Government Securities Act, 2006
6. The Reserve Bank of India Act, 1934
7. The Insurance Act, 1938
8. The Banking Regulation Act, 1949
9. The Forward Contracts (Regulation) Act, 1952
10. The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970
11. The Deposit Insurance and Credit Guarantee Corporation Act, 1961
12. The Foreign Exchange Management Act, 1999
13. The Insurance Regulatory and Development Authority Act, 1999
14. The Payment and Settlement Systems Act, 2007
15. The Acts establishing bodies corporate involved in the financial sector (e.g. The State Bank of India Act, 1955 and The Life Insurance Corporation Act, 1956)

7. IMPORTANT WEBSITES

http://www.fslrc.org.in/index.html