The Global Financial Crisis and the Indian Financial Sector
What Have We Learnt and How Have We Responded?¹

- Duvvuri Subbarao

Thank you very much for inviting me to speak at this conference of the Indian Merchants’ Chamber on international finance and banking. I attach a lot of value to speaking from this platform and to sharing some thoughts on financial and banking sector reforms.

2. In a few months from now, we will be marking the fifth anniversary of the collapse of Lehman Brothers which will go down in popular perception as the trigger for the biggest financial crisis of our time. Five years on, the crisis is still with us - only the geography, the immediate concerns and pressure points have changed.

Our World View of the Crisis

3. Even as the crisis is not yet over, it has changed our view of the financial sector in a fundamental way. The world view before the crisis was that the growth of the financial sector, in and of itself, was desirable; indeed that real growth can be induced by sheer financial engineering. Our faith in the financial sector grew to such an extent that before the crisis, we believed that for every real sector problem, no matter how complex, there is a financial sector solution. The crisis changed that. We now know that for every real sector problem, no matter how complex, there is a financial sector solution, which is wrong. In the pre-crisis euphoria of financial alchemy, we forgot that the goal of all development effort is the growth of the real

¹ Address by Dr. Duvvuri Subbarao, Governor, Reserve Bank of India at the 7th International Banking & Finance Conference 2013 organized by the Indian Merchants' Chamber at Mumbai on June 5, 2013.
Lessons of the Crisis

4. The crisis has also taught us to re-examine our understanding of the characteristics of financial markets and financial institutions. It will be instructive to briefly review what we learnt in this regard over the last five years.

5. The first thing we learnt is that price stability and macroeconomic stability do not guarantee financial stability. Note that the crisis erupted during a period of extraordinary price stability and macroeconomic stability. Indeed, some analysts have made an even stronger assertion, that an extended period of price and macroeconomic stability can blindside policymakers to seeing the festering financial instability underneath. We also learnt that no country is an island. Although the crisis originated in advanced economies, emerging economies too were affected, indeed by much more than they had thought possible. The contagion brought home a simple message. In a rapidly globalizing world, national and international financial stability are interlinked. They are really two sides of the same coin.

6. Another important lesson we learnt is that financial markets are not self correcting. Indeed in the pre-crisis years, a consensus was building around the view that modern risk management has increased the resilience of the financial sector, and that any excess would self correct in good time. The crisis proved that to be wrong. As we unlearnt that, we also learnt some new insights - that it is difficult to detect signs of pressure building up in the system in real time, that the financial sector can contain pressure for a longer time than we think possible, and as a consequence, when the inevitable implosion takes place, it can be quite disastrous, or even
catastrophic. We learnt that it is difficult to predict the precise nature of the implosion. For example, in the pre-crisis years, even the few who sensed stress building up in the system, thought there would be a currency crisis; in the event the implosion took the form of a financial sector crisis.

7. There were other lessons too. That a collection of rational financial institutions does not necessarily make a rational financial sector. In other words, rational behaviour at the individual institutional level does not aggregate to collective rationality because of the fallacy of composition. Financial institutions are notoriously prone to herd behaviour. They have a strong collective tendency to over expose themselves to the same type of risk during an upturn, and become overly risk averse during a downturn which can lead the whole system on a downward spiral of risk aversion, market seizure and instability.

**Converting Lessons into Policies**

8. I have so far spoken about the broader lessons of the crisis that have enhanced our understanding of the financial sector, especially of the financial sector in a highly integrated world. A logical question would be how are we converting those lessons into practical policies and systemic improvements. This is what I now want to turn to.

9. As you all know, the last four years have witnessed a vigorous debate internationally on how to foster a strong, stable and sustainable financial sector. There has already been significant agreement on some reforms while some important issues are still under debate.
**Emerging Economies and Global Reforms**

10. There have been some questions about why emerging economies too should adopt these reforms. Their argument is that it is the advanced economy financial sectors that had gone astray and it is they which need fixing. Emerging economy financial sectors, on the other hand, have been sound and resilient, and adopting reforms designed for the advanced economy context would be inappropriate, if also costly.

11. I believe such thinking is misguided. We live in a globalizing world with strong and growing interconnections between our financial systems. What happens anywhere in the world will have an impact everywhere, as indeed demonstrated by the experience of the last five years. As foreign banks come into our country, and our banks expand their global footprint, we cannot afford to be offline on global standards and international best practices. Also, note that, as the former Managing Director of the IMF said, just because this crisis originated in advanced economies, emerging economies cannot assume that they have insulated themselves from all future crises. Such hubris can be dangerously costly.

**Specific Issues**

12. Having set that context, I now want to turn to specific reform issues and cover each of them under three questions: (i) What have we learnt at the global level? (ii) Reflecting those lessons, how have we responded at the global level? (iii) How have we, in India, responded? I will address five specific issues.
1st Issue: Migration to Basel III

What have We Learnt?

13. By far the most significant and broad based reforms at the global level has been the agreement on the Basel III package for bank regulation. This package, which was discussed for over two years, is an attempt to reform the capital, leverage and liquidity regulations on banks reflecting the lessons of the crisis.

14. What are those lessons? First, in the pre-crisis period, common equity requirements for banks were pegged too low to provide for adequate loss absorption in a time of distress; second, there was no explicit regulation against leverage which allowed banks to become excessively leveraged without breaching the capital requirements; third, there were no explicit safeguards against liquidity risk, and this, in fact, proved to be the final straw for the crisis as liquidity shortage quickly snowballed into a crisis of confidence; and fourth, regulations demanded only light capital requirements against trading book exposures on the logic that trading book assets were low risk as they can be rapidly sold and positions can be quickly unwound.

What has Been the Global Response?

15. The Basel III package addresses these flaws. Most importantly, capital requirements have been tightened by more than doubling the minimum common equity requirement and also imposing, on top of that, a capital conservation buffer of 2.5 per cent of risk weighted assets (RWA) which can be drawn down in periods of stress. Further, new measures have been imposed to contain systemic risk in both the time and space dimensions. In the time dimension, the risk stems from the procyclical behaviour of financial institutions. This is sought to be mitigated through the requirement of a countercyclical capital buffer which will be built up
during the upswing of the economic cycle to be drawn down if there is a system wide risk in the downturn. The risk in the spatial dimension arises from the behaviour and business models of large financial institutions which, because of interconnections among financial institutions, can have a disproportionately large systemic impact. The moral hazard of ‘too big to fail’ is therefore sought to be mitigated by requiring systemically important financial institutions (SIFIs) to hold higher loss absorbing capital.

16. To prevent excess leverage, the Basel III package introduces a simple non-risk based leverage ratio to back-stop the risk based capital requirements. Besides constraining the build up of excessive leverage in good times, the leverage ratio also serves as a safeguard against model risk and against attempts to circumvent the risk based capital requirements. Basel III package contains a liquidity standard to ensure that banks carry adequate liquidity both for the short-term and the medium term.

*How have We, in India, Responded?*

17. In India, the Reserve Bank introduced the Basel III capital regulations for banks effective April 1 this year. The capital requirements will be phased over a period extending up to March 31, 2018, nine months ahead of the Basel Committee phase-in. In addition, the Reserve Bank has introduced a minimum Tier I leverage ratio which will be reviewed after the Basel Committee on Banking Supervision (BCBS) finalizes the leverage ratio calibration. We have also issued guidelines on ‘Liquidity Risk Management’ which include enhanced guidance on liquidity risk governance, measurement, monitoring and reporting to the Reserve Bank on liquidity positions. We will calibrate the precise parameters after the Basel Committee finalizes the entire framework.
18. As per our standard practice, we have pegged our minimum capital requirements for banks a percentage point higher than the minimum standards under Basel III [See Table below]

### Basel III Capital Requirements of Banks

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<tr>
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<th>Basel III (International)</th>
<th>Basel III (RBI)</th>
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<tbody>
<tr>
<td><strong>Common Equity</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minimum</td>
<td>4.5</td>
<td>5.5</td>
</tr>
<tr>
<td>Capital Conservation buffer (CCB)</td>
<td>2.5</td>
<td>2.5</td>
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<tr>
<td><strong>Total</strong></td>
<td>7.0</td>
<td>8.0</td>
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<tr>
<td><strong>Tier I Capital</strong></td>
<td></td>
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<tr>
<td>Minimum</td>
<td>6.0</td>
<td>7.0</td>
</tr>
<tr>
<td>Minimum + CCB</td>
<td>8.5</td>
<td>9.5</td>
</tr>
<tr>
<td><strong>Total Capital</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minimum</td>
<td>8.0</td>
<td>9.0</td>
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<tr>
<td>Minimum + CCB</td>
<td>10.5</td>
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19. What is the rationale for our more ‘onerous’ capital standards? The higher prescription is intended to address any judgemental error in capital adequacy viz. wrong application of standardised risk weights, misclassification of asset quality etc. Also, while advanced approaches under Basel II have been strengthened, the calibration of standardised risk weights is yet to be comprehensively effected. And more importantly, Indian banks have not so far been subjected to comprehensive pillar 2 capital add-ons under Basel II. The higher prescription is therefore
intended to address possible undercapitalisation of risky exposures. Experience shows that this prudence on our part was helpful and positive on the cost-benefit calculus.

20. How will Basel III impact the capital requirements of Indian banks? The Capital Adequacy Ratio (CAR) of the aggregate banking system as at end-December 2012 stood at 13.5 per cent with a Tier 1 capital ratio of 9.7 per cent. Initial estimates suggest that additional capital requirements would be of the order of ₹5 trillion, of which non-equity capital will be of the order of ₹3.25 trillion, while equity capital will be of the order of ₹1.75 trillion. It is expected that the long timeframe, upto March 2018, to phase in Basel III capital requirements will allow banks to make a smooth and non-disruptive transition.

2\textsuperscript{nd} Issue: Shadow Banking - Extending the Perimeter of Regulation

What have We Learnt?

21. The crisis has demonstrated how shadow banking can destabilize the financial system reinforcing the need to more effectively regulate it.

22. First a bit of background. Shadow banking is credit intermediation involving entities and activities outside the regular banking system. The pre-crisis regulatory architecture and regulatory culture provided a fertile ground for a thriving shadow banking sector to emerge. Regulators focussed on securing the safety of banks, but it was that exclusive and straitjacketed focus on banks that opened up opportunities for regulatory arbitrage in the form of shadow banks which mushroomed and proliferated without the shackles of regulation. Banks also found out that it was possible to transfer risky businesses and assets to the balance sheets of the shadow banks without transgressing any regulations.
23. But shadow banks were a crisis waiting to happen because of their low capital base, high leverage, interconnection with banks and risky business models. According to an estimate by the Financial Stability Board (FSB), the global shadow banking system, as conservatively proxied by ‘other financial intermediaries’, grew rapidly before the crisis, more than doubling from USD 26 trillion in 2002 to USD 62 trillion in 2007.

**What has Been the Global Response?**

24. At the international level, the post-crisis consensus is that if an entity behaves like a bank, it must also be regulated like a bank. To safeguard financial stability, it is necessary to monitor shadow banking system (from micro and macroeconomic perspectives) and regulate it, both directly as well as by regulating banks’ interactions with shadow banks.

25. The Financial Stability Board (FSB) issued a consultative document in November 2012 on ‘Strengthening Oversight and Regulation of Shadow Banking’ focusing on areas where policy intervention is warranted to mitigate the potential risks associated with shadow banking. The FSB, working with the BCBS and the International Organization of Securities Commissions (IOSCO), has focused on five specific areas: (i) mitigating the spill-over effect between the regular banking system and the shadow banking system; (ii) reducing the susceptibility of money market funds to “runs”; (iii) assessing and mitigating systemic risks posed by other shadow banking entities; (iv) assessing and aligning the incentives associated with securitization; and (v) dampening risks and pro-cyclical incentives associated with secured financing contracts such as repos, and securities lending that may exacerbate funding strains in times of “runs”.


How have We, in India, Responded?

26. Do we have shadow banking in India? In a sense yes, in the form of Non-Banking Finance Companies (NBFCs) which perform bank like financial intermediation. But what distinguishes our NBFCs from shadow banks is that unlike shadow banks which emerged and expanded outside of regulatory oversight, India’s NBFC sector has always been regulated, although less tightly than the banking system.

27. It is important in this context to note that our non-bank financial sector is very large, diverse and complex. Some of it is in the corporate sector, but much of it is in unincorporated. Different segments are regulated by different regulators. Some of the deposits raised by these companies are legal, some are illegal. In the wake of the recent melt down of a few finance companies in parts of the country, in the process destroying the entire life savings of millions of low income households, there is need to review the regulatory oversight of this sector keeping in view the mandatory and relative comparative advantages of the financial sector regulators. While tightening regulation is important, it is not sufficient. What is to be noted is that much of the fraud in the non-bank sector happens through unlawful and fraudulent schemes which should not be operating. This reinforces the importance of surveillance and enforcement, especially by the state governments.

28. For the record, I must say that RBI’s regulatory jurisdiction in the non-bank sector is restricted to NBFCs that are defined as companies in which financial assets comprise more than half the total assets and income from those financial assets constitutes more than half the gross income.
29. The Reserve Bank’s regulation of the NBFC sector focuses on both financial stability and consumer protection. The focus on financial stability is important because many of these NBFCs borrow from banks and their failure will have a negative impact on the balance sheets of banks and eventually on financial stability. The focus on consumer protection is important because, as I said earlier, thousands of low income households are lured into fraudulent financial schemes by the promise of unviably high rates of interest. In the Reserve Bank’s view, deposit taking should eventually be restricted only to banks which are tightly regulated. Deposit collection by non-banking companies should be gradually minimized, and eventually eliminated. Towards this endeavor, the Reserve Bank has been quite restrictive in authorizing NBFCs to collect deposits. Indeed the number of NBFCs allowed to collect deposits has come down from 1420 in 1998 to less than a fifth, 257, by 2013. Also deposit taking NBFCs comprise only about 2 per cent of the total number of NBFCs registered with the Reserve Bank.

3rd Issue: Subsidiarization of Foreign Banks

What have We Learnt?

30. The operation of foreign banks attracted a lot of attention during the crisis. One thing that became clear was that cross border banking transmitted the crisis ferociously across national jurisdictions, from the sub-prime US markets to financial markets around the world. At the same time, because of the complex structures of the large cross border banks, it became difficult to determine where in the system the risk lay and how it would transmit. There was no information on the organization structures of cross border banks and their links with related entities which left national regulators bewildered about how to douse the raging fires. The problem became more pronounced in cases where foreign banks were operating as branches rather than locally
incorporated subsidiaries highlighting the importance of countries making an explicit
determination of the mode of presence of foreign banks in the form of branch or subsidiary.

What has been the Global Response?

31. The crisis has shifted the bias towards domestic incorporation of foreign banks i.e.
subsidiarisation. Indeed, even pre-crisis, a number of jurisdictions mandated local incorporation
of foreign banks. The subsidiary form of presence provides several comforts to regulators. First,
a subsidiary has its own board of directors, including independent directors, which provides
sufficient separation between the bank and its owners to ensure that the interests of domestic
depositors are not compromised; second, the clear delineation between the assets and liabilities
of the bank and those of its parent affords greater leverage to the host country to ring fence the
operations of the bank; third, it is local economic conditions, rather than global perspectives, that
drive the managerial decisions of subsidiaries; and finally, it is easier to define the jurisdiction
whose laws would apply to the subsidiary, thereby affording more effective control to regulators
in a crisis situation.

How Have We, in India, Responded?

32. What is the policy in this regard in India? The road map for the presence of foreign banks
in India put out by the Reserve Bank in 2005 allows foreign banks a choice - of coming in either
as a branch or as a subsidiary - but not in both modes at the same time. Even so, all foreign banks
operating in India, currently 43 in number, have chosen to come in only in the branch mode.

33. Reflecting the lessons of the crisis, we deliberated in the Reserve Bank on whether in
India too we should require mandatory incorporation of foreign banks. Accordingly, the Reserve
Bank put out a Discussion Paper in 2011 marshalling the merits and demerits of this initiative.
The proposed framework leans towards the subsidiarization model for fresh entrants while nudging existing foreign banks with a balance sheet size above a threshold to convert from a branch model to a subsidiary model. It is expected that this will level the playing field for foreign banks and make the overall Indian banking system more competitive and inclusive.

34. In order to reach a final decision on this issue, we needed to clarify some taxation and legal issues. Over the last two years, we have worked with the Government to resolve the major taxation issues such as exception from stamp duty and capital gains tax on conversion from a branch to a subsidiary. We have yet to resolve a few legal issues which we hope can be done in the next few months. Thereafter, we expect to issue final guidelines.

**4th Issue: OTC Derivatives Market**

*What have We Learnt?*

35. Financial innovation in the pre-crisis years led to a marked expansion of the OTC (over the counter) derivatives. The general sense was that the OTC derivatives, being tailored/bespoke products, were deepening the financial markets and adding value to the real sector.

36. The crisis, however, exposed several weaknesses: excessive bilateral exposures with insufficient collateralisation, the inability of the market participants to price and value the derivatives, insufficient risk assessment, complexity and opacity of the products traded, all of which combined together to brew the crisis to explosive proportions because of the interconnectedness of the OTC derivatives market participants. It was clear that the OTC derivatives market outpaced the regulatory regimes.
What has been the Global Response?

37. The G-20 has taken leadership of the reform of the OTC derivatives with the goals of mitigating systemic risk, improving market transparency and regulatory oversight of OTC derivatives. The focus areas are standardization, central clearing, shifting all trading to exchanges or electronic platforms and reporting of trades to trade repositories. The FSB is monitoring the implementation of these reforms to ensure consistent and time bound implementation across all G-20 countries.

How have We, in India, Responded?

38. In India, the OTC derivative markets are relatively small and have developed within a regulated framework. As per the RBI Act, the validity of any OTC derivative contract is contingent on at least one of the parties to the transaction being a regulated entity. We introduced the OTC derivative products in a phased manner consistent with the hedging needs of the real sector. Even as the variety and complexity of OTC products in India are limited, the Reserve Bank has always been engaged in improving the transparency and reducing the counterparty risk in the OTC derivatives markets. As the products diversified, we focussed on the development of a robust market infrastructure for trading, settlement and reporting of transactions.

39. There have been significant reforms in OTC derivatives. In August 2007, we instituted a system for reporting the Rupee Forward Rate Agreement (FRA) and Interest Rate Swap (IRS) transactions to the CCIL’s reporting platform. A Trade Repository (TR) for OTC foreign exchange derivative products was launched in July 2012 and reporting of all major OTC foreign exchange derivatives to the TR has commenced. Taking note of international experience, reporting arrangements were put in place for Credit Default Swaps (CDS), right from their
introduction in December 2011. A Reserve Bank Working Group on Enhancing Liquidity in the Government Securities and Interest Rate Derivatives Markets recommended standardization of IRS contracts in order to improve their tradability and facilitate centralised clearing and settlement. To begin with, the inter-bank Rupee Overnight Index Swap (OIS) contracts have been standardised. The inter-bank OTC forex derivative contracts are largely standardised.

40. Infrastructure for the central clearing and guaranteed settlement of US Dollar-Indian Rupee (INR) inter-bank forex forward transactions has been in place since December 2009, which currently caters to around 30 per cent of the transactions. The Reserve Bank is working towards making the guaranteed settlement of the US Dollar-INR mandatory. The FRA and IRS trades in the INR are currently being centrally cleared in a non-guaranteed mode. The proposal to bring IRS and FRA transactions in the INR within the ambit of guaranteed settlement is engaging our attention.

5th Issue: Safeguarding Financial Stability

What have We Learnt?

41. Some of the most forceful lessons of the crisis are in the area of financial stability. We learnt that financial stability is important, much more so than we thought, because the costs of financial instability can be very heavy. We learnt that financial stability is an international public good - a disruption in the financial system anywhere can cause disruption in the financial systems everywhere. We learnt that price stability and macroeconomic stability do not guarantee financial stability; financial stability has to be guarded as an explicit variable. We learnt that signs of financial instability are difficult to detect in real time and that pressure can build up in the system for much longer than we think possible before an eventual implosion takes place.
What has Been the Global Response?

42. The post crisis reforms effort has accordingly focussed on three questions: (i) How do we define financial instability? (ii) What are the policy instruments for safeguarding financial stability? (iii) What should be the institutional arguments for safeguarding financial stability? There are no definitive answers to any of these questions; they are still being debated. Nevertheless, let me give you a flavour of the general approach to answers.

43. There seems to be general agreement that financial stability is difficult to define in concrete and quantifiable terms to suit all contexts. The consensus is that financial stability is a condition in which the financial system can withstand shocks thereby reducing the probability of disruption or breakdown of the system. Conversely, financial instability is a situation characterized by erosion of confidence in the financial system that results in market seizure, panic and collapse.

44. There is also consensus around the view that the tool kit for safeguarding financial stability is macroprudential policy which throws sand in the wheels of financial exuberance and excessive credit build up. The instruments in this regard include risk weights, provisioning norms, and loan to value ratios. The counter cyclical capital buffer too falls in this category.

45. While that much is clear, there are some intriguing questions and concerns on the way forward. What are the relative roles of monetary policy and macroprudential policies? Under what circumstances should one, rather than the other, be invoked? How do these policies interact with each other? If they are handled by different agencies, is it possible that they can work at cross purposes? Is there an inevitable political dimension to macroprudential policies? If yes, how does one protect the autonomy of the institution responsible for macroprudential policy?
That is a whole lot of deep and unsettled questions. Even as the search for answers is on, some countries, notably advanced economies where the crisis originated, have embarked on reforms of their institutional designs and regulatory architectures. These reforms reflect two clear trends: first, a decisive shift towards giving increased responsibility for both macroprudential oversight and microprudential regulation to central banks; and second, institutionalisation of collegial arrangements involving the central bank, other regulators and the Government, with the primary responsibility of identifying threats to financial stability. The councils can make recommendations for appropriate prudential standards in the interest of safety of the financial system, but notably, not for forbearance.

How have We, in India, Responded?

Historically, the Reserve Bank has played an important role in preserving financial stability - drawing from its wide mandate as the regulator of the banking system and of the payment and settlement systems, regulator of the money, forex, government securities and credit markets, as banker to banks, as also the lender-of-the last resort. This unique combination of responsibilities for monetary policy combined with macroprudential regulation and microprudential supervision with an implicit mandate for systemic oversight has allowed the Reserve Bank to exploit the synergies across various dimensions. The micro-level information coming from supervision of individual institutions has been a valuable input for shaping the macro perspective. On the other hand, the broad understanding from macroprudential regulation has been effective in instituting prudential safeguards at the micro institution level.

Recognizing the importance of an institutional mechanism for coordination among regulators and the Government, in December 2010, the Government established the Financial
Stability and Development Council (FSDC) to be chaired by the Finance Minister. The FSDC is to be assisted by a sub-committee to be chaired by the Governor of the Reserve Bank. This sub-committee has replaced the erstwhile High Level Coordination Committee on Financial Markets (HLCC-FM). The Government has held out a clear assurance that the working of the FSDC will not in any way erode the autonomy of the regulators.

49. The way forward from here in India is still uncertain. The FSDC has been meeting regularly, about 3 or 4 times a year, and has been focussed so far on stock taking and discussing policy issues. The agenda has been set more by immediate concerns, and there has been no explicit attempt to define what constitutes a ‘financial stability’ issue that falls within the domain of the FSDC.

50. Meanwhile, the Financial Sector Legislative Reforms Commission (FSLRC) submitted its report to the Government in March this year. In its submission to the Commission during the consultative stage, the Reserve Bank argued that the financial stability mandate that the Reserve Bank has been carrying out historically by virtue of its broad mandate should be clearly defined and formalized.

51. Nevertheless, the FSLRC has envisaged a different arrangement for safeguarding financial stability. Under this arrangement, the FSDC is accorded statutory status. The responsibility for safeguarding systemic risk is entrusted to the FSDC Board chaired by the Finance Minister and comprising all the regulators and agencies of the financial sector ‘which allows it to combine the expertise of the multiple agencies involved in regulation, consumer protection and resolution’.

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2 The FSLRC has preferred to use the term ‘systemic risk’ in preference to financial stability on the argument that ‘systemic risk’ renders clarity in communicating the problem and the risk.
52. The FSLRC recommendation that the executive responsibility for safeguarding systemic risk should vest with the FSDC Board runs counter to the post-crisis trend around the world of giving the collegial bodies responsibility only for coordination and for making recommendations.

53. The Reserve Bank has always held that financial stability cannot be its exclusive mandate, and that all regulators and the Government have to share the responsibility for financial stability, that coordination is important and that the Government has a more active role to play in a crisis time than in normal times. The Reserve Bank is also of the view that in a bank dominated financial sector like that of India, the synergy between the central bank’s monetary policy and its role as a lender of last resort on the one hand and policies for financial stability on the other is much greater.

54. In his speech at an ICSS Seminar on the Indian Financial Code last month, the Finance Minister alluded to the difficulties of getting legislation passed in India, especially a path breaking legislation of the type of the Indian Financial Code suggested by the FSLRC. He suggested that in the meanwhile, we should pursue the implementation of FSLRC suggestions within the framework of existing laws.

55. Within the task defined by the Finance Minister, on the issue of safeguarding systemic risk, we need to think through whether the responsibility of FSDC Board should be extended from being a coordination body to one having authority for executive decisions? What will that imply for the speed of decision making? Can we clearly define the boundaries between financial stability issues falling within the purview of the FSDC and regulatory issues falling exclusively within the domain of the regulators? Will this arrangement not mean compromising the synergy
between monetary policy and policies for financial stability? And what will it mean for the autonomy of regulators?

Conclusion

56. Let me now sum up. I started with the broad lessons we learnt about the financial sector - markets and institutions - as a result of the crisis. I then talked about the efforts at the global level to reach agreements on financial sector reforms and argued why it is important for emerging economies to adopt international standards. I then addressed five specific reform areas, in each case talking about the lessons of the crisis, the response at the global level and our response at the national level. I have concluded with the institutional arrangements for safeguarding financial stability, within the context of the FSLRC recommendations in this regard.

57. As someone said, this crisis is too important to waste. It has taken a devastating toll on global growth and welfare. All of us in the financial sector have a responsibility to distil the lessons of the crisis, reflect them in our policies and enforce those policies effectively so that we can minimize the probability of another crisis. What this means is that both the regulators and the regulated entities have to build internal capacities and become knowledge institutions. I hope this conference will be an important step forward in that direction.

I wish your deliberations all success.