livemint.com
THE WALL STREET JOURNAL.

- Posted: Tue, May 24 2011. 1:00 AM IST

RBI panel wants central bank to regulate all financial groups

Anup Roy & Aveek Datta

A working group of the Indian central bank on Monday proposed that all large financial groups should function under a financial holding company (FHC) structure and be regulated by the Reserve Bank of India (RBI) even if they do not have a bank in their fold. Such a move could put the central bank in conflict with a new super-regulator set up by the finance ministry.

There should be a separate regulatory framework and a new Act for such holding companies and, if necessary, amendments should be made to the existing Acts governing public sector banks, the Companies Act and other relevant Acts, the panel has proposed.

The central bank, which has posted the report on its website, has sought comments on the proposal until end-June.

The panel has proposed that a separate unit within RBI should be responsible for regulation. It can have staff from both the central bank as well as other regulators and the framework should also formalize a consolidated supervision mechanism through an understanding among watchdog agencies, the panel said.

The Act for FHCs should have the power to override other laws in case of any conflict and RBI should be designated as the regulator for them, it said.

In some sense, it wants to position RBI as a so-called super-regulator and blunt the power of the Financial Stability and Development Council (FSDC), a new inter-regulatory body chaired by the finance minister. FSDC was first proposed in Budget 2010 and came into existence in July of that year. The working group was set up in June.

A holding company model, according to the working group, will provide the requisite differentiation in regulatory approach for the holding firm vis-à-vis individual entities and enable better oversight of financial groups.

The recommendations of the working group will improve the appreciation of risks associated with capital deployed in separate businesses within a financial conglomerate, said Monish Shah, director at audit and consulting firm **Deloitte Touche Tohmatsu India Pvt. Ltd**.

While analysts agree that the proposals on creation of the FHC structure are a step in the right direction, some observed that a clear framework would be needed to ensure that regulators don't step on each other's toes.

"The report is a first fair step towards the ultimate objective of consolidating financial companies under a common regulator," said Karan Kalra, senior member of the banking and finance team at Mumbai-based law firm Nishith Desai Associates. "There is some scepticism about how regulators will combine under the current provisions of the report. A framework needs to be devised under which they can operate without sacrificing their respective autonomies."

Viren Mehta, director at audit and consulting firm **Ernst and Young India Pvt. Ltd**, said giving a single agency complete supervisory oversight was beneficial, though RBI would still need to work in close tandem with FSDC.

"Hopefully, going forward, policy decisions would be more congruent and consistent without getting pulled in various directions," he said. "There would still remain many stand-alone companies operating in verticals such as insurance and securities, regulated solely by respective regulators like Irda (Insurance Regulatory and Development Authority) or Sebi (Securities and Exchange Board of India). There needs to be commonality in the thought process that can be facilitated by FSDC."

Before the proposals can become norms, they will have to be accepted by RBI and it is unlikely these can be put in place without consulting other regulators.

Pending a separate Act, the working group said the FHC model should be operationalized under the provisions contained in the Reserve Bank of India Act and such entities will be registered as non-banking financial companies with RBI.

FHC should be a non-operating entity, but should be permitted to carry out all financial activities through subsidiaries. What it can and cannot do will be stipulated by RBI.

To ensure that FHCs with a banking business continue to focus more on that, "it would be necessary to put in place some limit on the expansion of the non-banking business", so that "growth of banking is not compromised by these groups in favour of growth of non-banking business".

Currently, a bank's investment in its subsidiaries is capped at 20% of net worth. Under the proposed structure, there will be a cap on how much a bank FHC can invest in its non-banking subsidiaries, but this has not been specified yet.

All new banks and insurance firms, as and when licensed, will mandatorily need to operate under the FHC framework.

"Those having insurance companies and (which) do not adopt the FHC model should comply with the extant regulations regarding promoters stipulated by Irda," the panel said.

RBI ruled out intermediate holding companies within FHC "due to their contribution to the opacity and complexity in the organizational structure".

Both State Bank of India and ICICI Bank Ltd, the two biggest lenders in India, had wanted to float such firms in the past, but RBI turned down their proposals citing regulatory concerns.

anup.r@livemint.com

Copyright © 2007 HT Media All Rights Reserved