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Learning from China's regulatory redesign

China recently redesigned its financial regulatory architecture, clarifying which agency will do what. It is time for India to revisit this issue

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Financial regulatory architecture is the question of what financial agencies should exist, and what their respective mandates should be. This is an important subject because performance comes out of accountability. Each financial agency requires a simple and clear mandate to be held accountable for performance. In addition, there are many elements of work in financial economic policy where conflicts of interest can hamper performance if certain functions are placed together. Reforms of financial regulatory architecture are extremely important, but any such proposal elicits yowls of protest from incumbent officials, as the fundamental law of bureaucratic politics is that power and turf must only go up.

It is not surprising to see serving officials of agencies oppose any reduction of their respective turf. However, this comes at a cost to society. A central bank that manages public debt will strive for low interest rates (i.e. cheap financing for the government) and has the perfect excuse for failure on its inflation target. A banking regulator overseeing closing failed banks will try and cover up regulatory failures by postponing closures. When financial stability and bank regulation are housed in the same agency, tensions arise.

In the global discourse, the bias today is to have a pure central bank that just does inflation targeting and no finance. Today's consensus best practice on financial regulation is either a single unified financial regulator or a "twin peaks" model with one regulator who looks at consumer protection and another who looks at prudential regulation. And alongside these, we need a separate public debt management agency, a separate financial resolution organisation, a consumer redress agency, and a tribunal to hear appeals.

The journey of reforming the agency architecture in India began with the Percy Mistry Committee in 2007, which said: "Key task in reforming regulatory architecture is to place all regulatory and supervisory functions connected with all organised financial trading (currencies, bonds, equities, corporate bonds, commodity derivatives; whether exchange-traded or OTC) into Sebi". This requires collecting together elements of law that are presently dispersed across many acts.

In September 2008, an experts committee set up by the Planning Commission recommended that regulatory structures be streamlined to avoid regulatory inconsistencies, gaps, overlap, and arbitrage. It went on to say that steps in this direction should include a reduction in the number of regulators, defining their jurisdiction wherever possible in terms of functions, rather than the forms of the players. The committee also felt that it is prudent to start the process of unifying regulation and supervision at certain levels, and recommended a strengthening and consolidation of regulatory structures.

Given that the world was still coming out of the devastation caused by the global financial crisis, it recommended the creation of a Financial Sector Oversight Agency (FSOA), by statute, for both macro-prudential as well as supervisory functions. Finally, the committee recommended setting up an Office of the Financial Ombudsman (OFO), incorporating all such offices in existing regulators, to serve as an interface between the household and industry, i.e., for consumer protection.

Acting on the recommendations of these expert committees, the Financial Sector Legislative Reforms Commission (FSLRC) proposed in 2011 a financial regulatory architecture comprising the following agencies:

1. The central bank as the monetary authority, banking regulator and payment system regulator.
2. A unified regulator for the rest of the financial sector.
3. A deposit insurance-cum-resolution agency.
4. A public debt management agency.
5. A financial redress agency.
6. A financial sector appellate tribunal.
7. A mechanism for coordination, systemic risk, financial development and other issues where the role of multiple agencies are involved (Financial Stability and Development Council or FSDC/similar to FSDC).

The FSLRC also recommended that further down the line, the central bank should be focused on only monetary policy.

In 2014, the chair of the 2008 expert committee but now in his capacity as Governor of the Reserve Bank of India, *strongly opposed* these recommendations as well *as his own* 2008 recommendations. He said: "As the Chinese would say, let us recognise the value of crossing the river by feeling each stone before we put our weight on it. Let us not take a blind jump hoping that a stone will be there to support us when we land. Or in American, if it ain't broke, don't fix it!".

Surprised? You should not be. Remember the power of bureaucratic turf!

Drawing on this nod, let us turn to the evolution of financial regulatory architecture in China. Their journey in thinking on these issues began in 2017-18. These translated into a series of recent decisions. These decisions reflect their initial conditions, their felt needs and experiences with failure, and the global contemporary wisdom on how these things should be done.

At the apex level, a Central Commission for Finance will be established for designing, coordinating, and overseeing the country's efforts to achieve financial stability and development. This new commission will replace the existing Financial Stability and Development Committee. The regulator of the securities market, namely the China Securities Regulatory Commission (CSRC), will continue to handle the securities market but will see its mandate being increased to include corporate bonds, including bonds issued by local governments. Everything else will fall under the remit of a new agency to oversee the financial sector, called the National Bureau of Financial Regulation (NBFR). This agency will replace the China Banking and Insurance Regulatory Commission (CBIRC) and will take over some of the supervisory functions of the Central Bank, i.e., the People's Bank of China (PBOC). This will include jurisdiction over fintech companies. This Bureau will also oversee consumer protection issues. These reforms will focus the central bank (PBOC) upon monetary policy.

In India, the last movement on this was the merger of Forward Markets Commission with Sebi in the aftermath of the National Spot Exchange Limited episode. Apart from this, this has been a frozen conflict. As with everything else in financial economic policy, the foundations of the knowledge are in place in India. What is now needed is a community that will lead the implementation challenge.

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