IMF and WB release the Financial System Stability Assessment (FSSA) and Financial Sector Assessment (FSA) respectively on their websites

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IMF and WB today released the Financial System Stability Assessment (FSSA) and Financial Sector Assessment (FSA) respectively on their websites. India welcomes assessment of the Indian financial system undertaken by the joint IMF-World Bank team conforming to the highest international standards. The Second comprehensive FSAP has now been successfully conducted for India in 2017.

FSAP, a joint program of the International Monetary Fund (IMF) and the World Bank (WB involved in developing countries and region only), undertakes a comprehensive and in-depth analysis of a country’s financial sector. Since September 2010, it is being undertaken in 25 jurisdictions (now 29), with systemically important financial sectors, including India, every five years. Last FSAP for India was conducted in 2011-12 and the report published by IMF on Jan 15, 2013.

The FSAP assessment acknowledges that India has recorded strong growth in recent years in both economic activity and financial assets with size of the financial system remaining broadly stable in terms of GDP at about 136 per cent. Increased diversification, commercial orientation, and technology-driven inclusion have supported growth in the financial industry, backed up with improved legal, regulatory, and supervisory frameworks. The FSAP report acknowledges many efforts by Indian authorities like tackling Non-Performing Assets (NPAs), recent recapitalization measures for banks and introduction of special resolution regime, formalization of National Pension System (NPS) and making the pension sector regulator statutory, passing of Insolvency and Bankruptcy Code and setting up of Insolvency and Bankruptcy Board of India (IBBI), to name a few. It appreciates initiatives such as ‘no frills’ account (under Jan DhanYojana), promoting digitization, introduction of unique biometric identification number (AADHAR), currency exchange initiative etc. It also recognizes the improved inter-agency co-operation since the establishment of Financial Stability and Development Council (FSDC), supported by its Sub-Committee and four technical groups and progress in setting up of Financial Data Management Centre (FDMC).

FSAP assessment acknowledges that RBI has made substantial progress in strengthening banking supervision by introduction of risk-based supervision in 2013 through a comprehensive and forward-looking Supervisory Program for Assessment of Risk and Capital (SPARC), domestic and cross-border cooperation arrangements, Asset Quality Review (AQR) and the strengthening of regulations in 2015 leading to improved distressed asset recognition, to name a few. The Basel III framework and other international norms have been implemented or are being phased in, including stricter regulations on large exposures. It also notes RBI establishing a new Enforcement Department and revising the Prompt Corrective Action (PCA) framework that incorporates more prudent risk-tolerance thresholds. The Report notes that risks in shadow banking sector in India were limited and that risks in non-bank financial subsectors appear contained but continue to warrant close monitoring.

The stress tests conducted by IMF FSAP experts covered the 15 largest banks, including 12 public sector banks (PSBs) which account for 71 per cent of the banking sector assets. The FSSA and FSA note that the largest banks appear sufficiently capitalized and profitable to withstand a deterioration in economic conditions. However, some PSBs have vulnerabilities and would be requiring additional capital. These capital needs were assessed between 0.75-1.5 per cent of GDP for baseline and adverse scenarios. This estimate was made prior to the announcement of the plan for recapitalization by Government of India. The post-assessment supplement points out that the major recapitalization plan for PSBs announced on October 24, 2017 amounting to approximately $32 billion or 1.3 per cent of GDP is expected to largely address the PSBs’ recapitalization needs. The reports, however, note that the provision of public capital should be contingent upon meaningful restructuring of PSBs. The FSAP also recommends that governance and financial operations of PSBs could be improved by developing a strategic plan for their consolidation, divestment, and privatization. The supplement also notes that on November 1, the Government of India announced the establishment of an Alternative Mechanism panel, headed by India’s Finance Minister, to seek consolidation across state-owned banks.

In relation to securities market, the report acknowledges that SEBI has made significant changes to its regulatory programs that directly address many findings and recommendations contained in the detailed IOSCO (International Organization of Securities Commissions) assessment published in 2013. SEBI has significantly expanded its regulatory programs, expanded its on-site inspection program and developed a risk-based matrix. The Amendments to the SEBI Act have granted SEBI additional investigative powers, created a special court that handles criminal cases filed by SEBI, and gave SEBI full authority to regulate pooled investment schemes exceeding Rs. 1 billion. The report also appreciates the measures undertaken to quicken the pace of bond market development.

The reports note that India is moving towards a new state-of-the-art bankruptcy regime and the newly created regime on insolvency and bankruptcy is comprehensive and aims at restructuring companies within ambitious timelines.

On the financial market infrastructures (FMIs), the FSAP team assessed that the RBI designated qualified central counterparty (CCP) that plays a critical role in money, G-sec repo and secondary markets has a prudent risk management framework and high operational reliability.

On resolution regime for financial institutions, while recognizing the efforts of Indian authorities in developing a comprehensive resolution framework through the Financial Resolution and Deposit Insurance (FRDI) Bill (“Bill”), the assessment identifies some gaps, including further strengthening of deposit insurance framework and resolution tools, particularly the bail-in power (cancellation of liabilities) being limited to contractual write-down of securities with explicit conversion clauses (as opposed to broader statutory bail-in powers), some duplication of supervisory authority in the pre-resolution phase and the requirement to modify the clause on preferential treatment of domestic creditors over foreign creditors. The Bill attempts to revamp and strengthen the deposit insurance framework in India, by providing for faster and stricter timelines for payment, and shifting to a risk-based premium framework for charging premiums from banks. With regard to bail-in, as the Report rightly points out, India currently has no provision for the same, and believes that only a consensual, hybrid form with both statutory and contractual forms of bail-in may be suitable for the country. The Bill also distinguishes, to the extent possible, the roles and responsibilities of the regulators and the resolution authority. Any duplication in their function is both unavoidable, and necessary, for the effective monitoring of distressed financial firms. On the issue of cross border co-ordination, the Bill gives flexibility to recognise or adopt support measures of foreign resolution actions through bilateral agreements, in the absence of which, in line with the prudential regulations in place in India, the creditors of the branch office in India, of a parent body established outside India would have first charge on the assets of the specified service provider for the purpose of resolution or liquidation under the Bill. The FRDI Bill, 2017 is presently under the consideration by a Joint Parliamentary Committee.

On the need for modernising insurance solvency framework and further development of risk-based supervision, IRDAI is already taking steps by drawing a road map on the implementation of risk based capital (RBC) system in India and is in the process of formulating an overall strategy to develop an appropriate “Risk Based Supervisory Framework” for effective and efficient monitoring and evaluation of potential risks in the insurance sector. On 21 Sep 2017, IRDAI has already formed a ten-member steering committee to implement the Risk Based Capital (RBC) Regime in accordance with the recommendation of Risk Based Capital Committee Report.

Government has also taken various steps to enhance investment in infrastructure sector including launching of innovative financial vehicles such as Infrastructure Debt Funds (IDFs), Real Estate Investment Trusts (REITs)/Infrastructure Investment Trust (InvITs), National Infrastructure Investment Fund (NIIF), laying down a framework for municipal bonds, allowing complete pass through of income tax to securitization trusts including trusts of Asset Reconstruction Companies (ARCs), bringing in 5/25 Scheme to extend long tenor loans to infrastructure projects, take-out finance, flexible structuring etc.

Recognizing that cyber security is critical for safeguarding the integrity and stability of the financial sector, Government has decided to set up a Computer Emergency Response team for the Indian Financial Sector (CERT-Fin), which will work in close co-ordination with all financial sector regulators and other stakeholders and initiatives in this regard are already under way.

The recommendations in case of India FSAP are mainly to bring about further improvements in the structure and functioning of the financial system and many of the detailed recommendations are in sync with the authorities’ own developmental plans.

As a member of the FSB, BCBS, IOSCO, IAIS and IMF, India actively participates in post-crisis reforms of the international regulatory and supervisory framework under the aegis of the G20. India remains committed to adoption of international standards and best practices, in a phased manner, calibrated to domestic needs and economic conditions, wherever necessary.

The FSAP scoping mission of the joint IMF-WB team visited India in December 2016 to outline the areas of financial sector to be covered in the exercise, followed by two more mission visits – in March and June-July 2017. The team met officials of various related Ministries/ Departments/ Agencies and all financial sector regulators i.e. RBI, SEBI, IRDAI and PFRDA and public and private sector participants.

The FSSA released by IMF can be accessed at www.imf.org.

The FSA released by World Bank can be accessed at www.worldbank.org

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